

1 MILBERG WEISS BERSHAD  
2 HYNES & LERACH LLP  
3 JEFFREY W. LAWRENCE (166806)  
CHRISTOPHER P. SEEFER (201197)  
4 AZRA MEHDI (*pro hac vice*)  
100 Pine Street, Suite 2600  
5 San Francisco, CA 94111  
Telephone: 415/288-4545  
415/288-4534 (fax)  
- and -  
6 WILLIAM S. LERACH (68581)  
401 B Street, Suite 1700  
7 San Diego, CA 92101  
Telephone: 619/231-1058  
8 619/231-7423 (fax)

9 WEISS & YOURMAN  
JOSEPH H. WEISS  
10 551 Fifth Avenue, Suite 1600  
New York, NY 10176  
11 Telephone: 212/682-3025  
212/682-3010 (fax)

12 Co-Lead Counsel for Plaintiffs

14 UNITED STATES DISTRICT COURT  
15 NORTHERN DISTRICT OF CALIFORNIA  
16 OAKLAND DIVISION

17 In re TUT SYSTEMS, INC. SECURITIES ) Master File No. C-01-2659-CW  
18 LITIGATION )  
----- )  
19 This Document Relates To: ) CLASS ACTION  
20 ALL ACTIONS. )  
----- )  
21 ) CONSOLIDATED CLASS ACTION  
22 ) COMPLAINT FOR VIOLATION OF THE  
23 ) FEDERAL SECURITIES LAWS  
24 )  
25 )  
26 )  
27 )  
28 )

DEMAND FOR JURY TRIAL

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## INTRODUCTION

1. This is a securities fraud class action against Tut Systems, Inc. ("Tut" or the "Company") and certain of its executive officers for violation of the federal securities laws. This action is also brought under Fed. R. Civ. P. 23, seeking certification of a class of persons and entities who purchased Tut securities between July 20, 2000 and January 31, 2001 (the "Class Period").

2. Tut sells broadband access systems that enable service providers (including competitive local exchange carriers ("CLECs") and building local exchange carriers ("BLECs")) to deliver high-speed data access to multi-tenant buildings. Tut's proprietary FastCopper Technology, HomeRun and LongRun Technology, permit high-speed data access over existing copper telephone lines. In essence, Tut's products enable multi unit buildings to provide internet access to their occupants. The Company's principal product offering, Expresso System Platforms, consists of a chassis containing management cards, interface cards and HomeRun or LongRun line cards. In 2000, over 40% of Tut's revenues were generated by a small number of service providers including Trigem Infocom, Inc. ("Trigem"), Reflex Communications, Inc. ("Reflex") and Darwin Networks, Inc. ("Darwin") who accounted for 18%, 12% and 11% of net sales, respectively.

3. Tut went public in 1/99 at \$18 per share, selling 2.875 million shares (including the overallotment) for proceeds of \$46 million. In 3/00, Tut completed a secondary offering, selling 2.5 million shares at \$60 per share for net proceeds of approximately \$141.7 million. Prior to the Class Period Tut consistently reported revenues that met or exceeded targets reported by analysts. At the beginning of the Class Period, defendants having led the market to believe that Tut would continue to meet or beat estimates, knew that the market expected Tut to report increasing revenues and earnings per share ("EPS") during 2000. They also knew that because the Company had essentially one product and was dependent on a small number of customers for a majority of its sales, product problems or the loss of any customers would materially and adversely impact Tut's revenue. By the summer of 2000, Tut had problems on both fronts

4. Several former employees of Tut have informed plaintiffs that beginning at least in the summer of 2000, the Company had significant problems with its products that caused them to overheat and fail. This led to the major, but undisclosed, recall at the beginning of the Class Period. In July, defendants

1       were informed by Trigem, Tut's largest customer, that it would no longer be purchasing Tut's products.  
 2       Other large customers were not paying Tut. These witnesses spoke on a confidential basis and are referred  
 3       to herein as confidential witnesses 1-4 ("CW\_\_"). They include a former Tut Director of Customer Service  
 4       ("CW1"), a former Regional Sales Manager ("CW2"), a former Customer Service Manager ("CW3"), and  
 5       a former Credit Manager ("CW4"). These witnesses have also informed plaintiffs that Tut's largest  
 6       customers received extended payment terms, were not required to pay for product until resale, and had  
 7       the right to return unsold product. Internal Company documents obtained by plaintiffs (and attached to the  
 8       Appendix of Exhibits to the Consolidated Class Action Complaint for Violation of the Federal Securities  
 9       Laws ("Appendix") filed herewith) confirm that Tut's largest customers did not pay for product as required  
 10      by the contracts between the parties and these "sales" should not have been recognized as revenue by the  
 11      Company.

12           5.       CW1 and CW3 both worked at Tut's headquarters in the Company's customer support  
 13       division both before and during the Class Period. Each was responsible for (1) responding to customer  
 14       complaints about Tut's products, (2) implementing and managing the recall, and (3) determining the causes  
 15       of the product defects. CW2 worked at Tut during and after the Class Period. As a Regional Sales  
 16       Manager, CW2 was responsible for selling Tut's equipment, interacting with customers and managing staff,  
 17       including sales representatives and sales engineers. CW2 prepared sales reports and participated in weekly  
 18       sales meetings led by Tut's Vice President of Sales. Thus, CW2 was familiar with the product problems  
 19       and payment terms required by the contracts between Tut and its customers, extended payments terms  
 20       granted to Tut's customers and the problems Tut's customers had paying Tut. CW4 worked at Tut during  
 21       and after the Class Period. As a Credit Manager, CW4 was responsible for approving credit for new  
 22       customers, approving customer shipments and collections for both new and existing customers. Thus,  
 23       CW4 was familiar with the extended payment terms granted to Tut's customers and the problems  
 24       customers had paying Tut.

25           6.       Having conditioned the market to expect increased growth and earnings with widespread  
 26       product problems and the loss of Trigem, defendants knew that they could not meet these expectations  
 27       without a new, substantial source of revenue. The new and substantial source of revenue came from a  
 28       sham transaction with Reflex. Reflex had purchased approximately \$1.9 million of product from Tut in the

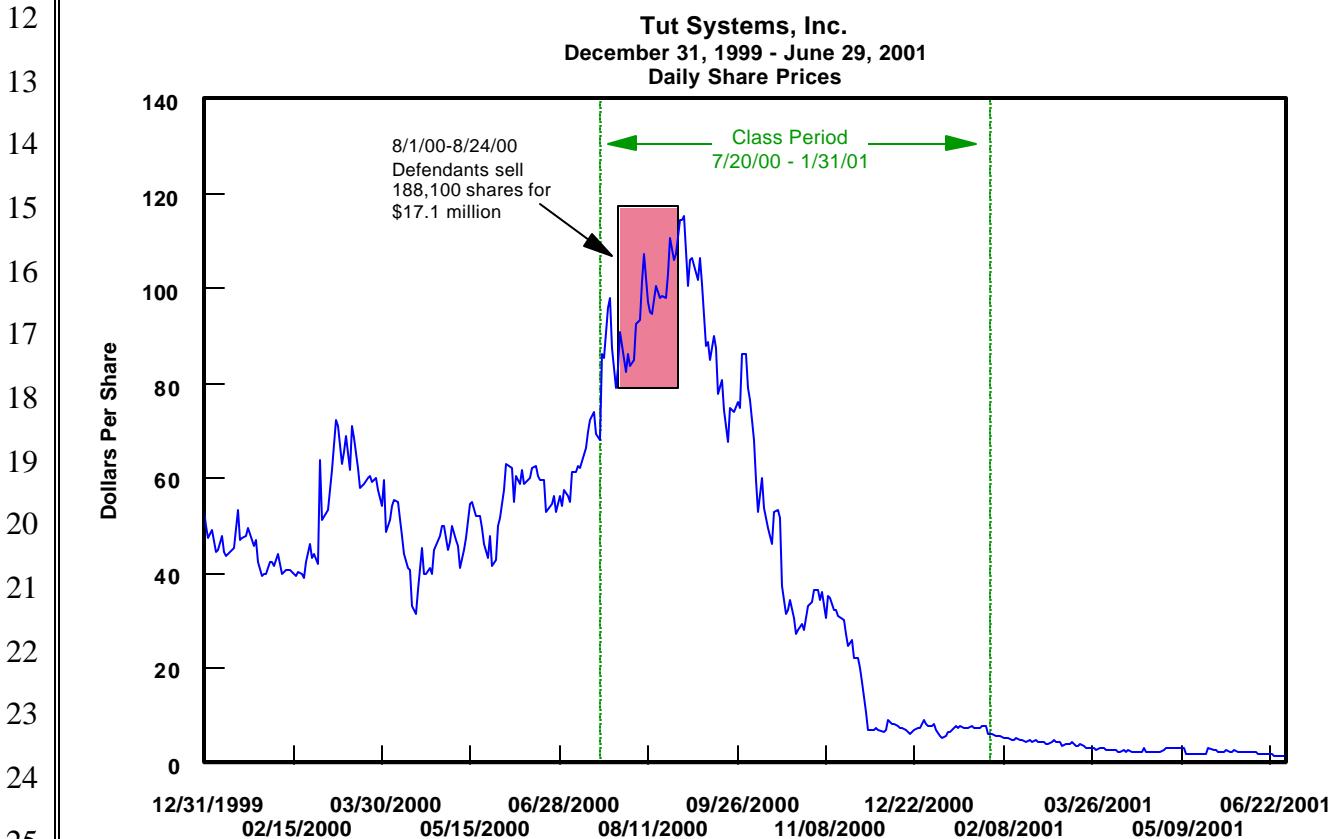
1 first six months of 2000 pursuant to a channel partner agreement between the two companies. The  
 2 agreement required Reflex to purchase \$1.5 million of product in 3Q00. On 7/14/00, two days after Tut  
 3 purchased 1.3 million shares of Reflex's series B private preferred stock in 7/00, Tut began shipping  
 4 approximately \$7 million of product in 3Q00 – more than four times the amount required under the channel  
 5 partner agreement. Defendants knew that this was far more product than Reflex could use or pay for, but  
 6 nevertheless caused Tut to recognize \$7 million of revenue in 3Q00 on this sham transaction. In fact, Tut  
 7 shipped product to Reflex even though Reflex had not paid for prior shipments. Reflex never used or paid  
 8 for any of the product and declared bankruptcy shortly thereafter.

9       7. Defendants' fraud principally involved (1) the concealed design and manufacturing defects  
 10 with the Espresso System Platforms that caused the Platforms to overheat and fail, and Tut's undisclosed  
 11 major recall of all Platforms in the summer of 2000, and (2) the reporting of fraudulent financial results for  
 12 the quarters ending 6/30/00 ("2Q00") and 9/30/00 ("3Q00"). As set forth more fully below, defendants  
 13 caused Tut to report inflated financial results during the Class Period by (1) improperly recognizing  
 14 revenues on sales of the defective product, (2) improperly recognizing revenues on contingent sales to its  
 15 largest customers including Trigem, Reflex and Darwin, (3) improperly recognizing revenues on the  
 16 undisclosed sham affiliate transaction with Reflex when Tut had no expectation of payment, (4) failing to  
 17 adequately reserve for uncollectible accounts receivable and (5) failing to reserve for obsolete and excess  
 18 inventory.

19       8. The Class Period begins on 7/20/00, with Tut's announcement of record 2Q00 revenues  
 20 and its first ever proforma profit. As a result of defendants' positive false statements Tut's stock price  
 21 increased 26% from \$68.25 on 7/19/00 to close at \$86.3125 on 7/20/00. These financial results were  
 22 false and misleading because Tut improperly recognized revenues on sales of defective product that  
 23 customers had returned pursuant to Tut's undisclosed recall in the summer of 2000. Additionally, Tut also  
 24 improperly recognized revenues on sales to its largest customers, including Trigem and Darwin which  
 25 accounted for 33% and 14% of the Company's revenues for the six months ending 6/30/00. Defendants  
 26 boasted about the growth of Tut's sales to the multi-tenant industry but failed to disclose the design and  
 27 manufacturing problems with the Espresso System Platforms and the decision to recall *all* of the  
 28

1 Company's products. Defendants also failed to disclose that its largest customer, Trigem, would not buy  
 2 any product from Tut in 3Q00 and thus its revenue and earnings would not be growing as they had forecast.

3         9.         The Company's stock price continued to rise in 7/00 and 8/00 reaching a Class Period high  
 4 of \$120.375 on 8/29/00. Defendants, taking advantage of the Company's inflated stock price, sold  
 5 188,100 shares, or 46.5% of their total available holdings for illegal insider trading proceeds of more than  
 6 \$17 million. With full knowledge of the undisclosed product problems, recall, the loss of the Company's  
 7 largest customer (Trigem) and the concealed sham transaction with Reflex, each of the individual defendants  
 8 suddenly sold their shares in unison during a narrow three week period from 8/1/00-8/24/00, with several  
 9 of the individual defendants selling their shares on the same day. As shown below, defendants' 8/00 sales  
 10 were at prices between \$83.13 and \$104.3, – virtually the highest prices in all of 2000 – and far in excess  
 11 of the \$5.8438 price at which Tut stock traded at the end of the Class Period.



10.         In 9/00 and 10/00, the price of Tut's stock declined closing at \$51.875 on 10/17/00. Several analysts reported the decline was due to concerns about financing issues related to competitive local exchange carriers ("CLECs") and building local exchange carriers ("BECGs"), many of whom had

1 recently issued earnings warnings and disclosed financing problems. Nevertheless, analysts predicted that  
 2 Tut would report impressive 3Q00 financial results. Defendants knew of this problem firsthand as  
 3 numerous customers including Darwin, CAIS Internet, Rycom and Reflex were all delinquent in paying Tut.

4       11. On 10/18/00, defendants caused Tut to report record revenues and earnings for 3Q00 that  
 5 exceeded analyst expectations. Despite these positive false statements, the price of Tut's stock declined  
 6 further to \$36.875 on 10/18/00 and to \$27.75 on 10/19/00. Analysts and the financial press attributed  
 7 the decline to the announcement by one of Tut's competitors, Copper Mountain Networks, Inc., that it  
 8 expected 4Q00 financial results to decline.

9       12. In 11/00 and 1/01 even though they continued to withhold material information about their  
 10 product defects and recall, Tut began to condition the market for the inevitable decline in its stock price.  
 11 At that time, Tut substantially reduced revenue guidance for 4Q00 from \$34.2 million to \$6-\$7 million  
 12 telling the market (falsely) that this 80% reduction was the result of adverse developments in the  
 13 telecommunications industry that had affected Tut's service provider customers. As a result, Tut's stock  
 14 price dropped to below \$10 per share but still traded at artificially inflated levels due to the improper  
 15 revenue recognition and failure to reserve for uncollectible receivables, and excess and obsolete inventory.  
 16 ***Indeed, despite the record financial results reported for 2Q00 and 3Q00, Tut reported increasing  
 17 and deteriorating levels of receivables and inventories.***

18       13. On 1/31/01 Tut reported horrible financial results and massive write-offs of uncollectible  
 19 receivables and worthless inventories - finally accounting for the problems that had begun in the summer  
 20 of 2000. Tut reported 4Q00 revenues of less than \$6 million and a staggering loss of \$68 million or  
 21 (\$4.12) EPS. The bad debt reserve which was approximately \$500,000 during the Class Period was  
 22 increased to \$21.2 million – a 3800% increase. Tut wrote off more than \$1 million of inventory and the  
 23 Company's reserve for obsolete and excess inventory increased from approximately \$1.9 million at 9/30/00  
 24 to \$13.8 million at 12/31/00 - a 600% increase. Tut also incurred a \$19 million charge for cancelled  
 25 purchase orders and a \$3.1 million charge to write-off the Company's equity investment in three customers  
 26 (including Reflex and Darwin). This announcement caused the Company's stock price to fall to as low as  
 27 \$5.84, causing hundreds of millions of dollars in damages to members of the class.

28

1           14. Since the end of the Class Period, the problems at Tut have only gotten worse. In the three  
 2 quarters since the end of the Class Period, Tut has reported declining sales, massive additional write-offs  
 3 of excess and obsolete inventories and huge losses. The inventory reserve was increased by more than \$33  
 4 million and Tut reported a net loss of \$104.3 million or (\$6.39) EPS for the year ending 12/31/01. The  
 5 Company's stock price has not recovered and currently trades at prices less than \$2 per share.

#### **JURISDICTION AND VENUE**

7           15. The claims asserted herein arise under §§10(b) and 20(a) of the Securities Exchange Act  
 8 of 1934 ("1934 Act"), 15 U.S.C. §§78j(b) and 78t(a), and Rule 10b-5. Jurisdiction is conferred by §27  
 9 of the 1934 Act, 15 U.S.C. §78aa.

10          16. Venue is proper here pursuant to §27 of the 1934 Act. The acts and transactions giving  
 11 rise to the violations of law complained of occurred here.

#### **THE PARTIES**

13          17. Lead plaintiffs are Mark Krist and Robin O. Avery. Each of these class members  
 14 purchased Tut securities at artificially inflated prices during the Class Period and were damaged thereby.

15          18. Defendant Tut designs, develops and sells advanced communications products that enable  
 16 service providers to deliver over existing copper telephone lines high-speed data access to multi tenant  
 17 buildings. Tut maintains its headquarters at Pleasanton, California. During the Class Period, Tut's securities  
 18 traded in an efficient market on the NASDAQ National Market System. Tut owned stock in Darwin and  
 19 Reflex, two of its largest customers in 2000. Tut improperly recognized more than \$16 million of revenues  
 20 on contingent sales to Darwin and Reflex in 2000. Tut incurred losses of at least \$12 million on these sales  
 21 because Darwin and Reflex failed to pay Tut more than \$12 million and eventually declared bankruptcy.  
 22 Tut also lost more than \$3.1 million on its equity investments in three customers including Reflex and Darwin  
 23 due to the bankruptcies of the two companies.

24          19. (a) Defendant Salvatore D'Auria ("D'Auria") was, during the Class Period, Chairman,  
 25 President and Chief Executive Officer of the Company. Per the Company's Bylaws, all corporate powers  
 26 were to be exercised under the authority of the Board of Directors of which D'Auria was Chairman. The  
 27 Bylaws also required the Board of Directors to conduct, manage and control the business affairs of the  
 28 Company. As Chairman, D'Auria presided at all Board of Director meetings. Under the Company's

1 Bylaws, D'Auria, as President and CEO, had general supervision, direction and control of the business,  
 2 other officers and employees of Tut. In 2000 D'Auria received a salary of \$249,519 and a bonus of  
 3 \$140,625. Between 8/1/00-8/22/00, D'Auria sold 55,100 shares of Tut stock for insider trading proceeds  
 4 of \$5.2 million. D'Auria was also a shareholder of Darwin, one of Tut's largest customers.

5                         (b)      Defendant Nelson Caldwell ("Caldwell") was, during the Class Period, Vice  
 6 President of Finance and Chief Financial Officer of the Company. Per the Company's Bylaws, the CFO  
 7 was required to keep and maintain adequate and correct accounts of the properties and business  
 8 transactions of the Company, including accounts of its assets, liabilities, receipts, disbursements, gains,  
 9 losses, capital, surplus and shares. As CFO Caldwell signed Tut's 2Q00 and 3Q00 Form 10-Qs filed with  
 10 the Securities and Exchange Commission ("SEC"). In 2000 Caldwell received a salary of \$171,923 and  
 11 a bonus of \$70,500. Between 8/1/00-8/18/00, Caldwell sold 19,200 shares of Tut stock for insider  
 12 trading proceeds of \$1.78 million. Caldwell was also a shareholder of Darwin. Caldwell resigned from  
 13 Tut in 8/01.

14                         (c)      Defendant Allen Purdy ("Purdy") was, during the Class Period, Vice President-  
 15 Sales of the Company until his resignation on 9/30/00. In 2000 Purdy received a salary of \$41,033, a  
 16 bonus of \$38,625 and \$104,351 pursuant to separation agreement. Between 8/3/00-8/24/00, Purdy sold  
 17 8,800 shares of Tut stock for insider trading proceeds of \$779,055.

18                         (d)      Defendant Sanford Bennett ("Bennett") was, during the Class Period, Chief Operating  
 19 Officer of the Company until his resignation on 11/30/00. In 2000, Bennett received a salary of \$124,216,  
 20 a bonus of \$65,013 and \$215,799 pursuant to a 10/30/00 employment agreement. On 8/4/00, Bennett sold  
 21 5,000 shares of Tut stock for insider trading proceeds of \$415,890.

22                         (e)      Defendant Matthew Taylor ("Taylor") was Founder, Chief Technology Officer and  
 23 Director during the Class Period until his resignation from all positions at the Company effective 1/19/01.  
 24 In 2000, Taylor received a salary of \$150,000 and a bonus of \$35,625. Between 8/1/00-8/17/00, Taylor  
 25 sold 100,000 shares of Tut stock for insider trading proceeds of \$8.9 million.

26                         20.     The defendants referred to in ¶¶19(a)-(e) are referred to as the "Individual Defendants."  
 27 Because of their senior executive and managerial positions with Tut, the Individual Defendants had access  
 28 to the adverse undisclosed information described herein regarding the Company's business operations,

1 financial condition, products, markets, customer relationships, and present and future business prospects  
 2 and product demand. In fact, the running of the business, the maintenance of its financial health and success  
 3 of the mergers and acquisitions were the principal responsibilities of the Individual Defendants. The  
 4 Individual Defendants knew or recklessly disregarded that said adverse undisclosed information had not  
 5 been disclosed to, and was being concealed from, the investing public.

6       21. Because they were responsible for running the Company, it is appropriate to treat the  
 7 Individual Defendants as a group for pleading purposes and to presume that the false, misleading and  
 8 incomplete information contained in the Company's public filings, press releases and other publications as  
 9 alleged herein are their collective actions. Each of the Individual Defendants was directly involved in the  
 10 day-to-day operations of the Company at the highest levels, was privy to confidential proprietary  
 11 information concerning the Company and its business, operations, products, growth, financial statements,  
 12 and financial condition, as alleged herein. Said defendants knew of the product problems and recall and  
 13 were involved in drafting, producing, reviewing and/or disseminating the false and misleading statements  
 14 and information alleged herein, were aware of or deliberately disregarded that the false and misleading  
 15 statements were being issued regarding the Company, and approved or ratified these statements, in  
 16 violation of the federal securities laws.

17       22. As officers, directors and controlling persons of a publicly held company whose securities  
 18 was, and is, registered with the SEC pursuant to the 1934 Act, traded on the NASDAQ, and governed  
 19 by the provisions of the federal securities laws, the Individual Defendants each had a duty to disseminate  
 20 promptly accurate and truthful information with respect to the Company's financial condition and  
 21 performance, growth, operations, financial statements, business, products, markets, management, earnings  
 22 and present and future business prospects, and to correct any previously issued statements that had become  
 23 materially misleading or untrue, so that the market price of the Company's securities would be based upon  
 24 truthful and accurate information. The Individual Defendants' misrepresentations and omissions during the  
 25 Class Period violated these specific requirements and obligations.

26       23. Each of the defendants is liable as a direct participant in, and a co-conspirator with respect  
 27 to the wrongs complained of herein. In addition, the Individual Defendants, by reason of their positions,  
 28 are "controlling persons" within the meaning of §20 of the 1934 Act and had the power and influence to

cause the Company to engage in the unlawful conduct complained of herein. Because of their positions of control, the Individual Defendants were able to and did, directly or indirectly, control the conduct of the Company's business.

4       24. The Individual Defendants, because of their positions with the Company, controlled and/or  
5 possessed the authority to control the contents of its reports, press releases and presentations to securities  
6 analysts and through them, to the investing public. The Individual Defendants were provided with copies  
7 of the Company's reports and press releases alleged herein to be misleading, prior to or shortly after their  
8 issuance and had the ability and opportunity to prevent their issuance or cause them to be corrected. Thus,  
9 each of the defendants had the opportunity to commit the fraudulent acts alleged herein.

## **SUBSTANTIVE ALLEGATIONS**

#### **A. Description of the Company and Its Products**

12        25.     Tut was incorporated in 1983 and began operations in 1991. From 1991 through most  
13 of 1998, substantially all of Tut's revenue was derived from the sale of XL Ethernet LAN extension  
14 products to the corporate and university segments of the multi-tenant commercial unit ("MCU") market.  
15 In early 1997, Tut introduced the first products in the Expresso product line for the Internet service  
16 provider markets and in early 1998, began licensing its HomeRun technology to semiconductor, computer  
17 hardware and consumer electronics manufacturers for incorporation into integrated circuits and consumer  
18 products, including PCs, peripherals, modems and other Internet appliances. In the second half of 1998,  
19 Tut commenced selling the Expresso GS products, which were configured for local loop applications, and  
20 Expresso multi-dwelling unit ("MDU") products, which incorporated Tut's HomeRun technology to a  
21 broader range of service providers, primarily those serving apartment complexes, hotels, university  
22 dormitories and military complexes in the MDU market.

23        26. According to the Company's SEC filings and website, Espresso MDU and Espresso GS  
24 products consist of a compact, modular central-site shelf or chassis containing a management card, ethernet  
25 MUX card, T-1 WAN Router card, ethernet switch card, and up to 17 xDSL, HomeRun or LongRun line  
26 cards. Those products enable multi-unit buildings to provide Internet access to their occupants over  
27 existing copper telephone wires.

1           27.     Tut went public in 1/99 at \$18 per share, selling 2.875 million shares (including the  
 2 overallotment) for proceeds of \$46 million. It was a "hot" IPO and Tut's stock traded between \$20 and  
 3 \$50 during most of 1999. In early 1999, Tut began selling Expresso MDU products incorporating LongRun  
 4 technology and Expresso MDU Lite into additional segments of the MDU market. In late 1999, Tut began  
 5 selling its Expresso SMS 2000 and companion Expresso OCS system providing subscriber management,  
 6 bandwidth management, credit card billing and other functions to the MDU market, and in early 2000, Tut  
 7 began selling its OneGate Internet server appliances, acquired as a result of its acquisition of FreeGate  
 8 Corporation, to the MCU market.

9           28.     In 2/00, Tut had acquired FreeGate Corporation for \$25 million, mostly in Tut stock, and  
 10 in 5/00 Tut acquired Xstreamis for \$19 million in stock. Tut was attempting to integrate these and other  
 11 acquisitions as the Class Period began.

12          29.     In 3/00, Tut completed a secondary offering, selling 2.5 million shares at \$60 per share for  
 13 net proceeds of approximately \$141.7 million. Tut's stock declined from the \$60+ range to the mid \$20's  
 14 in the spring of 2000 with the general tech stock decline but began to recover as summer 2000 began.

15          30.     Following the Company's IPO in 1/99 and its secondary offering in 3/00, several analysts  
 16 including those from the investment banks that underwrote the IPO, initiated coverage of Tut and issued  
 17 reports based on and repeating information provided to them by defendants. Prior to the Class Period Tut  
 18 reported revenues that met or exceeded targets reported by these analysts. For example, on 1/19/00 Tut  
 19 reported 4Q99 revenues of \$10.6 million and (\$0.35) EPS, and FY99 revenues of \$27.8 million and  
 20 (\$1.12) EPS which exceeded estimates by Lehman Brothers analyst, Steven D. Levy and Kaufman Bros.  
 21 analyst, Clifton Gray.

22          31.     On 4/19/00 Tut reported 1Q00 revenues of \$16.5 million and (\$0.22) EPS. On 4/19/00  
 23 Kaufman Bros. analyst Clifton Gray and Lehman Brothers analyst Steven D. Levy each reported that Tut's  
 24 1Q00 revenues and EPS were well above their projections. Clifton had projected 1Q00 revenues of \$11.6  
 25 million and (\$0.24) EPS. Levy had projected 1Q00 revenues of \$11.5 million and (\$0.30) EPS. Clifton  
 26 also reported the (\$0.22) EPS exceeded the consensus First Call estimate of (\$0.28) EPS. Clifton and  
 27 Levy each increased their revenue and EPS projections for the remainder of 2000 based on these reported  
 28 results and based on guidance provided by the Company. Each reiterated their "strong buy" and "buy"

1 ratings on the stock. Clifton recommended that investors buy the stock aggressively at its current \$41 price  
 2 and predicted the stock price would increase to as high as \$100.

3 **B. Tut's Revenue Was Dependent on Sales of Its Expresso Products to a Small Number of  
 4 Customers**

5 32. According to the Company's SEC filings Tut generated revenue primarily from the sale of  
 6 products and, to a lesser extent, from technology licenses. Product revenues comprised 94.5% and 97.2%  
 7 of total revenues in 1999 and 2000. The Company represented in its SEC filings that it recognized product  
 8 revenue in accordance with Generally Accepted Accounting Principles ("GAAP"), *i.e.*, when (1) persuasive  
 9 evidence of an arrangement existed, (2) delivery had occurred, (3) the fee was fixed and determinable, and  
 10 (4) collectibility was probable. The Company also represented in its SEC filings that inventories were  
 11 reported at the lower of cost or market. Tut reported increasing quarterly revenues in 1999 and throughout  
 12 the Class Period.

13 33. A majority of Tut's sales in 1999 and 2000 came from a small number of customers. Tut's  
 14 ten largest customers accounted for 62% of net sales in 1999 and 72.2% of net sales in 2000. In 1999,  
 15 CAIS, Inc. and Rycom CCI, Inc. ("Rycom") accounted for 12% and 11% of net sales. In 2000, Trigem  
 16 Infocom, Inc. ("Trigem"), Reflex Communications, Inc. ("Reflex") and Darwin Networks, Inc. ("Darwin")  
 17 accounted for 18%, 12% and 11% of net sales. Other large customers included I-Quest, Velocity HSI,  
 18 Inc., and Ardent, Inc. (dba CAIS, Inc. and CAIS Internet). The Company's ability to report increasing  
 19 quarterly revenues was dependant on continued sales to these customers.

20 34. Thus, throughout 2000 and at the beginning of the Class Period, defendants led the market  
 21 to believe that Tut would continually meet or beat estimates and knew that the market expected Tut to report  
 22 increasing revenues and EPS during 2000. They also knew that because the Company was dependent on  
 23 a small number of customers for a majority of its sales, any decline in sales to those customers would  
 24 materially and adversely impact Tut's revenue.

25 35. As set out below, by the summer 2000 defendants knew that Tut's primary product offering,  
 26 the Expresso System Platform, contained significant design and manufacturing defects that caused the  
 27 product to overheat and fail, and which led to a recall of *all* Expresso System Platforms. Additionally, by  
 28 July, defendants learned that Trigem, Tut's largest customer in the first half of 2000, would no longer be

1 purchasing Tut's product. Defendants also knew customers Darwin, CAIS, Rycom and Reflex were  
2 delinquent. Thus, by at least the beginning of 3Q00, defendants knew that Tut could not meet, let alone  
3 exceed, the revenue and earnings that they had led the market to expect.

4       36.     Tut was only able to report increasing quarterly revenues and EPS during the Class Period  
5 by (1) improperly recognizing revenues on sales of defective product, (2) improperly recognizing revenues  
6 on contingent sales to the Company's large customers, including sham sales to Reflex, by then a related  
7 party, (3) failing to adequately reserve for the Company's increasing and deteriorating level of receivables,  
8 and (4) failing to adequately reserve for excess and obsolete inventory.

## **DEFENDANTS' SCHEME TO DEFRAUD**

**A. Defendants Caused Tut to Improperly Recognize Revenues on Sales in 2Q00 and 3Q00 of Products that They Knew Were Defective**

37. As set forth in the Company's SEC filings, Tut's principal product offering was the Expresso System Platform. The Expresso System Platform product line included Expresso MDU, Expresso MDU Lite, Expresso GS and Expresso SMS 2000. Expresso MDU and Expresso GS products consisted of a compact, modular central-site shelf (or chassis) that contained various components including a management card, interface cards and multiple HomeRun or LongRun line cards. Each of these product offerings integrated the Company's FastCopper technology and were designed to provide high-speed data access to multi-tenant buildings over existing copper telephone wires.

38. According to CW1, a former Director of Customer Service, and CW3, a former Customer Service Manager, throughout 2000, many of Tut's Espresso System Platforms did not work and the Company did not have a strong engineering staff to make them work. Indeed, CW1 stated that many of the products CW1 tested prior to shipment were deplorable. CW1 and CW3 stated that customers constantly returned defective products to Tut prior to and during the Class Period including Trigem, Tut's largest customer in 2000. By the summer of 2000 Tut had determined that the problems with the product involved both design and manufacturing defects. CW1, CW2, CW3 and CW4 stated that Tut instituted a major recall of these defective products in the summer of 2000.

39. The primary problem with the Expresso System Platforms were defects in the HomeRun and LongRun line cards – the heart of Tut's products – that caused the Platforms to overheat and catch fire.

1 CW1 and CW3 stated that the cards caught fire due to contamination problems. CW2 and CW4 also  
 2 stated customers returned product because they were overheating and catching fire. As disclosed in the  
 3 Company's 2000 Form 10-K, Tut did not manufacture any of its own products. Rather, Tut relied on  
 4 contract manufacturers to assemble, test and package the Company's products. CW1 stated that Tut relied  
 5 on one company to manufacture the cards, Dovatron, and hired Xerox and NCR to install the cards. CW1  
 6 and CW3 stated that some of the cards NCR was installing (including a card installed at the Hilton Hotel  
 7 in St. Louis) caught fire because of contamination problems. CW1 stated that Expresso Systems delivered  
 8 to customers of I-Quest and Darwin also overheated and caught fire. Specifically, CW1 stated that  
 9 something between the glue and the solder and AC converter was contaminated which caused the card to  
 10 get hot and the glue to act as a catalyst (the manufacturing problem). By the summer of 2000, CW1 brought  
 11 this problem to the attention of senior management, including all of the Individual Defendants, but Tut  
 12 continued to ship the defective boards. According to CW1 Tut continued to use Dovatron after the problem  
 13 was discovered. Although Tut began to spot check the product before shipment, CW1 said defective  
 14 product continued to be shipped because Tut was not testing the product in the same environment that Tut's  
 15 products were operating in at customer sites.

16       40.      Generally, Tut's Expresso Systems were installed in a closet in the basement of the multi-  
 17 tenant building. CW1 said that initially the spot check Tut performed was simply running electricity through  
 18 the cards in an open chassis. The chassis were not enclosed and did not replicate the environment Tut's  
 19 products were operating in at customer sites. CW1 stated that Tut's customer service department along with  
 20 Quality Assurance and Operations subsequently replicated the "flameout" problem in the lab by placing a  
 21 box over the MDU chassis to simulate the environment the Expresso Systems were operating in. CW1  
 22 stated that the cards flamed during these replication tests.

23       41.      CW1 also stated that the problem was not just a manufacturing defect but a design defect.  
 24 Specifically, CW1 stated that the cards, and the components that were part of the cards, were not designed  
 25 to withstand temperatures the cards were exposed to in the chassis at customer sites. CW1 stated that the  
 26 HomeRun and LongRun line cards were the cards that overheated and caught fire because they transmitted  
 27 most of the traffic.

28

1           42. CW1 stated the recall was instituted prior to 8/00. CW3 stated that D'Auria, Caldwell,  
 2 Bennett, Purdy and others made the decision to recall the product and that Caldwell sent CW3 an email  
 3 directing CW3 to begin retrieving product. The recall was not publicly disclosed. CW1 stated that during  
 4 the recall some customers sent back the entire chassis and others sent back the defective cards. In addition,  
 5 Tut sent engineers to customer sites to replace defective cards with new cards. CW3 stated that thousands  
 6 of cards were returned to Tut and placed in warehouses located in Pleasanton and Walnut Creek. CW1  
 7 stated that as soon as Tut instituted the recall, Tut's receiving bay was filled with returned product. CW1  
 8 stated that every day Tut would receive approximately 10 boxes of returned product each containing  
 9 approximately 2-3 chassis. CW1 stated that on several occasions the volume of returns was so high that  
 10 employees could not physically get into the shipping/receiving area because it was filled with the recalled  
 11 product.

12           43. CW1 stated that Tut staggered notifying customers about the recall because Tut did not have  
 13 enough new product to replace all of the defective cards. CW3 said sales and customer support were  
 14 fighting over new product. Sales wanted the new product to ship and generate new sales. Customer  
 15 support needed the product to replace the defective product for existing customers. CW1 stated that  
 16 initially, CAIS Internet, Darwin and I-Quest were the first to receive replacements for defective product  
 17 because they were triple stacking chassis and the first customers to experience the overheating problems.  
 18 CW3 also stated that Darwin and CAIS Internet received replacements for defective product. According  
 19 to Tut's 1Q00 Form 10-Q, I-Quest was Tut's second largest customer generating 17% or \$2.8 million of  
 20 Tut's 1Q00 revenues. According to Tut's 2Q00 Form 10-Q, Darwin and I-Quest were Tut's second and  
 21 third largest customers generating revenues of \$5.2 million and \$3.7 million in the six months ending 6/30/00.

22           44. CW1 stated that Tut's upper management knew the product problems were rampant. CW3  
 23 said everyone in the Company knew about the problem. CW2 and CW4 knew about the cards catching  
 24 fire. Indeed, given that Tut was essentially a one-product company (with different variations), and all of the  
 25 product was recalled, it was impossible *not* to know about the product defects. For example, when CW4  
 26 was first asked about Tut's products the witness said, you mean the ones that kept catching fire? Further,  
 27 CW1 also stated that the product problems were discussed at weekly staff meetings attended by defendants  
 28 D'Auria, Caldwell, Bennett, and other Tut executives including Marilyn Lobel (Tut's Controller during the

1 Class Period and its current CFO), Mark Carpenter (Tut's Vice President of Marketing during the Class  
 2 Period), Thomas Warner (Tut's Vice President of Engineering during the Class Period who reported to  
 3 Taylor) and Avi Caspi (Tut's Vice President of Operations during the Class Period). CW1 stated that  
 4 Warner told CW1 that Taylor knew of the product problems. CW1 also stated that during the recall there  
 5 were often 2-3 meetings per day. CW1 said that D'Auria and Caldwell also participated in conference calls  
 6 with CAIS Internet and Darwin to update those companies on the status of replacing the defective product.  
 7 CW1 also stated that D'Auria held defendant Benett responsible for the product problems. Benett resigned  
 8 from Tut effective 11/30/00.

9       45.     CW1 stated that another problem was that Tut's ethernet boards were supposed to, but did  
 10 not, have a collision detection feature which allowed a modem to determine whether there was any traffic  
 11 on the lines before e-mails were sent. This situation created huge problems for Tut's customers. CW1  
 12 stated that the ethernet boards did not work for customers because the e-mails were colliding with each  
 13 other and the computer. The computer would attempt again and again to send the e-mails further clogging  
 14 the lines due to the lack of the collision detection feature.

15       46.     Defendants caused Tut to improperly recognize revenues on sales of defective products in  
 16 violation of GAAP and the Company's publicly reported revenue recognition policy and falsely represented  
 17 that revenue to the market. ¶¶101-112. Both GAAP and Tut's revenue recognition policy did not permit  
 18 revenue recognition upon shipment unless, among other things, collectibility was probable. Collectibility was  
 19 not probable due to the product defects. *See* AICPA Statement of Postion ("SOP") 97-2.

20       47.     Further, Financial Accounting Standards Board ("FASB") Statement of Financial Accounting  
 21 Concepts ("FasCon") No. 5 states that revenues are not to be recognized until earned. FasCon No. 5 at  
 22 ¶83(b). Revenues are earned when the entity has substantially accomplished what it must do to be entitled  
 23 to the benefits represented by the revenues. *Id.* If collectibility is doubtful, revenues may only be recognized  
 24 when cash is received. ¶84(g). Tut had not substantially accomplished what was required (*i.e.*, shipping  
 25 nondefective product) for it to recognize the revenues.

26 **B. Defendants Caused Tut to Improperly Recognize Revenues on Contingent Sales to Its  
 27 Largest Customers and Sales to Reflex, an Undisclosed Related Party**

28

1           **1. Contingent Sales**

2       48. According to Tut's SEC filings, Trigem, Reflex and Darwin accounted for 41% of Tut's sales  
 3 in 2000. Trigem, a Korean distributor, accounted for \$12.9 million or 18% of Tut's 2000 revenues. A  
 4 majority of these revenues - \$12.4 million - were recognized by Tut in 1Q00 (\$5.9 million) and 2Q00 (\$6.5  
 5 million). Indeed, Trigem accounted for 33% of Tut's revenues for the six months ending 6/30/00. Darwin  
 6 accounted for \$7.9 million or 11% of Tut's 2000 revenues. Of that amount, \$5.2 million was recognized  
 7 by Tut in the first two quarters of 2000 and \$2.7 million was recognized in 3Q00. Darwin did not generate  
 8 any revenues in 4Q00. Tut, D'Auria and Caldwell were Darwin shareholders. Reflex accounted for \$8.6  
 9 million or 12% of Tut's 2000 revenues – all of it by 9/30/00. According to documents filed by Tut in the  
 10 Reflex bankruptcy, including Tut's Aged Receivables Report, the vast majority of these revenues –  
 11 approximately \$6.7 million – were recognized by Tut in 3Q00.

12       49. Tut's sales to Darwin and Reflex were governed by Channel Partner Agreements ("CPA").  
 13 Copies of these agreements are attached to the Appendix and incorporated by reference. The Darwin CPA  
 14 had an effective date of 12/99 and was executed by defendant Taylor on 12/21/99. The Reflex CPA had  
 15 an effective date of 9/3/99 and was executed by defendant Caldwell. Both CPAs required Darwin and  
 16 Reflex to pay Tut within 30 days of acceptance. Under the CPAs, Darwin and Reflex could not return  
 17 product to Tut after the expiration of the rejection period (15 business days from the date of delivery)  
 18 without Tut's prior written consent.

19       50. According to CW1, Tut's largest customers, including Trigem, Darwin and Reflex, did not  
 20 have to pay and did not pay Tut until they actually resold the product to their customers. CW2 stated that  
 21 defendant D'Auria extended payment terms to Darwin, Reflex and CAIS Internet and continued to ship  
 22 these customers product even though they had not paid for previous purchases. CW4 stated that defendant  
 23 Caldwell automatically gave Tut's large customers like Darwin, Reflex, CAIS Internet and Rycom extended  
 24 payment terms and directed CW4 to ship product to nonpaying customers. Further, CW1 informed  
 25 plaintiffs that Tut's largest customers also had the right to, and did, return product that they were unable to  
 26 resell. Under these circumstances, GAAP precluded Tut from recognizing revenues until its channel partners  
 27 resold Tut's product and paid Tut. *See SOP 97-2, FASB Statement of Financial Accounting Standard*  
 28 ("SFAS") No. 48, FasCon No. 5.

1       51.     Tut's SEC filings and documents filed in the Darwin and Reflex bankruptcies confirm Tut's  
 2 customers did not pay their accounts as required by the CPAs. Tut's SEC filings in 2000 disclosed a  
 3 substantial increase and deterioration in the Company's receivables. Receivables tripled from 1Q00 to  
 4 3Q00, increasing from \$10.3 million at 3/31/00 to \$15.4 million at 6/30/00 to \$30.6 million at 9/30/00.  
 5 Further, days sales outstandings ("DSOs") also deteriorated from 67 days at 6/30/00 to 97 days at 9/30/00.  
 6 The increase in receivables and DSOs reflected customers failure to pay within 30 days of acceptance.

7       52.     According to Tut's SEC filings, Tut recognized revenue of \$5.2 million in the first two  
 8 quarters of 2000 and \$2.7 million in 3Q00 on sales to Darwin. All of the \$7.9 million should have been paid  
 9 to Tut within 30 days of acceptance in accordance with the Darwin CPA. However, Tut's objection to the  
 10 proposed sale of Darwin's assets filed with the bankruptcy court reveals that Darwin did not pay Tut \$5  
 11 million. That unpaid \$5 million does not include \$1.5 million paid by Darwin to Tut on 11/14/00 that the  
 12 Darwin Bankruptcy Trustee has sued Tut to return. Tut's filing in the Darwin bankruptcy confirms Darwin  
 13 did not pay Tut as required by the CPA.

14       **2. Related Party Sales to Reflex**

15       53.     According to CW3 Trigem purchased Tut's MDU Lite product in the first half of 2000.  
 16 CW3 stated that Trigem stopped purchasing product from Tut in 3Q00 because it was able to purchase a  
 17 similar product for a lower price from a Korean company. Thus at the beginning of 3Q00, at the same time  
 18 that Tut was in the midst of dealing with major product design and manufacturing defects and a recall of all  
 19 of its products, it lost 33% of its revenue.<sup>1</sup> Defendants needed to obtain a revenue source if they had any  
 20 hope of reporting the growth that they had led the market to expect. They found the "revenue" in Reflex.

21       54.     According to Tut's 2000 Form 10-K filed on 4/2/01, Reflex accounted for \$8.6 million or  
 22 12% of Tut's 2000 revenues – all of it by 9/30/00. According to documents filed by Tut in the Reflex  
 23 bankruptcy, including Tut's Aged Receivables Report, the vast majority of these revenues - approximately  
 24 \$6.7 million - were recognized by Tut in 3Q00.

25       55.     Under the Reflex CPA, Tut agreed to sell Reflex its products at substantial discount  
 26 provided that Reflex purchased certain milestone amounts in specified quarters. Thus, under the CPA Reflex

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27       28       <sup>1</sup> Tut's Form 10-Q for the period ending 9/30/00 disclosed that Trigem did not generate any revenue  
                  in 3Q00.

1 was obligated to purchase \$600,000 in 4Q99, \$900,000 in 1Q00, \$1.2 million in 2Q00, \$1.5 million in  
 2 3Q00 and \$1.8 million in 4Q00 to be eligible for a 40% price discount. According to documents filed by  
 3 Tut in the Reflex bankruptcy, including an "Aged Receivables Report," for the first half of 2000, Reflex  
 4 purchased approximately \$1.9 million of Tut's products, a little less than the \$2.1 million needed to be on  
 5 track under the terms of the CPA.

6       56.     On 7/12/00, Tut purchased 1.3 million shares of Reflex preferred stock in a \$33 million  
 7 private placement. A copy of Tut's preferred stock certificate is attached to the Appendix and incorporated  
 8 by reference. Over the next several days, Tut sent Reflex invoices totaling approximately \$1.9 million –  
 9 equal to all the product Relfex had purchased from Tut in the entire first six months of 2000. In 8/00, the  
 10 purchases doubled to \$4.1 million and in 9/00 Tut invoiced Reflex an additional \$650,000, for a quarterly  
 11 total of \$6.7 million. Thus, in 3Q00 Reflex "purchased" over four times the amount of product required  
 12 under the CPA for that quarter.

13       57.     In 7/00-8/00, CW1 asked a senior sales executive why Tut was shipping so much  
 14 equipment to Reflex when CW1 was sure they couldn't use all of it. The executive's response was in  
 15 essence that because they (Tut) were shareholders in Reflex, they could do whatever they wanted. CW1  
 16 also recalled a similar conversation with an employee in the sales process who commented that Reflex (and  
 17 Darwin) didn't have a choice in the matter, "If we tell them they have to take the merchandise, then they have  
 18 to take it." According to CW4, Tut was shipping product to Reflex even though Reflex was not paying for  
 19 the shipments.

20       58.     Documents filed by Tut in the Reflex bankruptcy, including the "Aged Receivables Report"  
 21 reveal that Reflex did not pay Tut \$7.07 million for product purchased in 2000. The Aged Receivable  
 22 Report is an exhibit to defendant Caldwell's declaration filed in the Reflex bankruptcy and is attached to the  
 23 Appendix. Tut's Aged Receivables Report and SEC filings reveal that approximately \$6.7 million of the  
 24 \$7.07 million was purchased by Reflex in 3Q00 - the quarter Trigem generated no sales for Tut. Reflex did  
 25 not generate any revenues in 4Q00. Reflex did not pay Tut for any of the product purchased in 3Q00 and  
 26 filed for bankruptcy protection shortly thereafter.

27       59.     According to a declaration filed by Edmund Wood, the Reflex Bankruptcy Trustee, much  
 28 of the product sold to Reflex was never sold to Reflex's customers, remained in its original packaging and

1 was warehoused by Reflex at various locations around the country including rental properties, storage  
 2 lockers, home garages of some Reflex managers and in leased vans. A copy of this declaration is attached  
 3 to the Appendix. Nevertheless, these "sales" allowed Tut to announce "triple digit" growth in 3Q00.

4 **C. Throughout the Class Period Defendants Caused Tut to Materially Overstate Earnings  
 5 by Not Reporting Inventory at the Lower of Cost or Market**

6 60. Tut falsely represented in its SEC filings that it reported inventory in accordance with GAAP  
 7 at the lower of cost or market. In fact, due to the product problems and returns, Tut failed to adequately  
 8 reserve for returned defective products and obsolete inventory. Tut's CPAs included warranty terms that  
 9 required Tut to repair or replace defective product. According to CW1 and CW3, if a customer  
 10 complained about product purchased from Tut, the customer could ship the product back to Tut and Tut  
 11 would replace the product free of charge, often with new or upgraded products. CW1 and CW3 stated  
 12 that returned product was placed in warehouses by Tut. Moreover, as set forth in ¶¶37-44, substantial  
 13 amounts of recalled defective Espresso Platform Systems were returned to Tut during the Class Period and  
 14 stored in Tut warehouses. During the Class Period, Tut's gross inventory quadrupled from \$12.8 million  
 15 at 3/31/00 to \$50.0 million at 12/31/00. However, even though defendants knew that Tut's products were  
 16 defective and therefore worthless, Tut did not reserve for its defective, obsolete and excess inventory until  
 17 after the Class Period. Despite the huge increase in inventory and the recall of defective product, during the  
 18 Class Period, Tut only increased its reserve from \$1.2 million at 3/31/00 to \$1.9 million at 9/30/00. Then,  
 19 in 4Q00, Tut increased its provision for obsolete and excess inventory by \$13 million and wrote off an  
 20 additional \$1.1 million.

	<u>3/31/00</u>	<u>6/30/00</u>	<u>9/30/00</u>	<u>12/31/00</u>
Gross Inv.	\$12,842	\$16,861	\$24,160	\$50,040
Provisions	732	358	385	12,993
Write-offs	0	0	0	(1,131)
Reserves	1,150 <sup>2</sup>	1,508	1,893	13,755
Net Inv.	11,692	15,353	22,267	36,285

28 2 The beginning balance of the reserve for excess and obsolete inventory at 12/31/99 was \$418,000.

1       61.     However, even the massive increase in the reserve for obsolete and excess inventory  
 2 incurred by Tut in 4Q00 was insufficient to report Tut's inventory in accordance with GAAP at the lower  
 3 of cost or market. In the first three quarters of 2001 Tut has incurred an additional \$33.3 million in charges  
 4 to reserve for excess and obsolete inventory. Thus, in the eight months since the end of the Class Period,  
 5 Tut incurred more than \$48 million in charges to reserve for obsolete, defective and excess inventory.

6 **D. Defendants Caused Tut to Materially Overstate Earnings by Not Adequately  
 7 Reserving for Uncollectible Accounts Receivable**

8       62.     Defendants knew Tut's earnings were materially overstated due to the failure to reserve for  
 9 uncollectible receivables. In addition to the improper revenue recognition described in ¶¶37-59, defendants  
 knew Tut's customers were not paying.

10      63.     According to CW4, in 9/00 product shipments to Darwin and CAIS Internet were placed  
 11 "on hold" because they had not paid Tut. CW4 also stated that Reflex was shipped product in 3Q00 even  
 12 though they were not paying Tut. CW4 also stated that defendant Caldwell directed CW4 to ship product  
 13 to Rycom in 12/00 despite Rycom's \$700,000 account being past due. Defendants also knew about  
 14 customer delinquencies from Tut's Aged Receivables Report. For example, the Aged Receivables Report  
 15 for Reflex disclosed that Reflex had not paid Tut for any of the \$6.7 million of product shipped in 3Q00 and  
 16 that Reflex owed Tut a total of \$7.07 million.

17      64.     As detailed in ¶¶51 and 106, Tut's receivables increased and deteriorated throughout the  
 18 Class Period. Receivables tripled from \$10.4 million at 3/31/00 to \$30.6 million at 9/30/00. DSOs  
 19 increased from 67 days at 6/30/00 to 97 days at 9/30/00.

20      65.     Despite the improper revenue recognition, customers' failure to pay and the corresponding  
 21 increase and deterioration in Tut's receivables, the Company's bad debt reserve was only \$335,000 at  
 22 3/31/00, \$537,000 at 6/30/00 and \$543,000 at 9/30/00. Tut failed to adequately reserve for the  
 23 Company's uncollectible receivables until after the Class Period when it increased the bad debt reserve by  
 24 3600% to \$21.2 million and wrote off an additional \$1.7 million of receivables.

## **FALSE AND MISLEADING STATEMENTS DURING THE Class Period**

**A. Defendants' False and Misleading Statements Regarding Tut's 2Q00 Financial Results**

66. False Statement: On 7/19/00, Tut announced its 2Q00 results in a press release which stated:

Tut Systems, Inc. More Than Quadruples Revenues ...

Tut Systems, Inc. today reported a strong second quarter performance with ***revenues for the quarter ended June 30, 2000, of \$21 million***, an increase of 319%, compared to revenues of \$5 million for the quarter ended June 30, 1999. This quarter ***Tut achieved its first quarter of operating profitability on a pro forma basis*** – a quarter ahead of internal expectations.

***The net income for the quarter*** ended June 30, 2000, excluding certain noncash purchase acquisition expenses of \$1.8 million, ***was \$0.6 million, or \$.04 per share***, compared with a net loss for the quarter ended June 30, 1999, of \$(2.7) million or \$(.23) per share. Net loss for the quarter ended June 30, 2000, including noncash purchase acquisition expenses, was \$(1.2) million.

"This is an exciting milestone for Tut to achieve pro forma profitability this rapidly in the fiscal year," said Tut Systems, Inc. President and Chief Executive Officer, Sal D'Auria. "Additionally, we beat our internal goals for every single financial metric including a two point increase in our gross margins. *Clearly, these kind of results show our business is accelerating beyond our expectations with a clear path for continued growth in future quarters.*"

*"In the MTU market place, Tut also expanded its leadership position with total shipments to date of more than 17,000 building systems and over 200,000 lines to the multi-tenant industry," said D'Auria.* "And, the exciting thing about this industry, is that systems deployments to commercial and residential multi-tenant buildings throughout the world are just beginning to be rolled out. Our internal calculations show that only 1-2% of MTUs have building systems in them today – which indicates an enormous opportunity for Tut to continue to sell our multi-tenant solutions all over the world."

20 The Company's financial results reported in the 7/19/00 press release were repeated to the market in analyst  
21 reports issued on 7/20/00 by Kaufman Bros. analyst Clifton Gray, Oscar Gruss & Son, Inc. analyst Ayelet  
22 Oron and Frost Securities analyst Syed E. Haider (copies of which are attached to the Appendix and  
23 incorporated by reference). Each analyst also reiterated their recommendations on the Company's stock  
24 and Gray increased the target price of Tut's stock to \$145 from \$100 per share.

67. Reasons Why and Defendants' Knowledge that Their Statements Were False and Misleading: The financial results and other positive statements contained in the 7/19/00 press release and the 7/20/00 analyst reports were materially false and misleading for the reasons set forth in ¶¶37-65.

1 Defendants knew they were misleading the analysts into serving as conduits for distributing false information  
 2 to investors.

3                         (a)     As detailed in ¶¶37-65, defendants knew the revenue and EPS numbers reported  
 4 for 2Q00 and the six months ending 6/30/00 were materially overstated because Tut (1) improperly  
 5 recognized revenues on sales of defective products, (2) improperly recognized revenues on contingent sales,  
 6 (3) failed to establish adequate reserves for obsolete and excess inventory and (4) failed to establish  
 7 adequate reserves for uncollectible accounts receivables.

8                         (b)     As detailed in ¶¶37-59, Tut improperly recognized revenues on sales of defective  
 9 product that was subject to a major recall and improperly recognized revenues on sales to its largest  
 10 customers that were not required to pay Tut until they had resold the product.

11                         (c)     D'Auria's representation that Tut's business was "accelerating beyond our  
 12 expectations with a clear path for continued growth in future quarters" was false and misleading because of  
 13 the product problems that required a major recall of Expresso System Platforms. Further, Trigem, Tut's  
 14 largest customer in 1Q00 and 2Q00, would not be purchasing any product from Tut in 3Q00. Defendants  
 15 knew this because Trigem and Tut's other customers provided rolling forecasts to the Company.

16                         (d)     As detailed in ¶¶53-59, in response to the loss of Trigem, defendants began shipping  
 17 millions of dollars of product to Reflex in 7/00, 8/00 and 9/00 that Reflex never paid for. After Tut  
 18 purchased 1.3 million shares of Reflex's preferred stock in 7/00, Reflex was suddenly shipped approximately  
 19 \$7 million of product in 3Q00. Although the Reflex CPA required payment within 30 days of acceptance,  
 20 plaintiffs have been informed by CW1, CW2 and CW3 that, in fact, Reflex (and Tut's other large customers)  
 21 were not required to pay until they resold Tut's product. CW4 stated that Reflex was shipped product even  
 22 though they were not paying Tut. Documents filed in the Reflex bankruptcy confirm Reflex did not pay for  
 23 **any** of the \$6.7 million of product shipped to them in 3Q00 and that much of the product was never used  
 24 and remained in its original packaging.

25                         (e)     As detailed in ¶¶62-65, Tut's failure to adequately reserve for uncollectible  
 26 receivables was reflected by the increase and deterioration of receivables. Receivables increased from  
 27 \$11.7 million at 3/31/00 to \$15.4 million at 6/30/00. DSOs increased to 67 days in the same time period.  
 28 However, the bad debt reserve was only increased by \$202,000. As shown by Tut's SEC filings and

1 documents filed by Tut in Darwin's bankruptcy, Darwin was not paying Tut within 30 days for the \$5.2  
 2 million of product purchased in 1Q00 and 2Q00. Despite the foregoing, Tut shipped another \$2.7 million  
 3 of product to Darwin in 3Q00. After the Class Period, Tut incurred more than \$20 million in charges to  
 4 increase the bad debt reserve to \$21.2 million as of 12/31/00.

5                         (f)         In addition to the product problems and recall detailed in ¶¶37-47, Tut's failure to  
 6 adequately reserve for obsolete, defective and excess inventory was reflected by the increase in net  
 7 inventory from \$10.4 million at 3/31/00 to \$15.4 million as of 6/30/00. Despite the product problems, recall  
 8 and corresponding increase in inventory, Tut incurred a \$1.1 million expense in the first six months of 2000  
 9 (\$732,000 in 1Q00 and \$358,000 in 2Q00) to increase its inventory reserve from \$418,000 at 12/31/99  
 10 to \$1.5 million at 6/30/00. After the Class Period, Tut incurred more than \$48 million in charges to reserve  
 11 for obsolete, defective and excess inventory.

12                 68.         False Statement: On 7/27/00, Tut filed its 2Q00 Form 10-Q with the SEC. The Form 10-Q  
 13 was signed by defendant Caldwell and repeated the financial results contained in the 7/19/00 press release.  
 14 It was represented in the Form 10-Q that the financial statements contained therein reflected all adjustments  
 15 necessary to present fairly the Company's financial position, results of operations and cash flows as of and  
 16 for the three and six months ending 6/30/00 and 6/30/99. The Form 10-Q also included the following  
 17 representations:

18                 Manufacturing or design defects in our products ***could*** harm our reputation and business.

19                 Any defect or deficiency in our products ***could*** reduce the functionality, effectiveness or marketability of our products. While we consistently attempt to improve  
 20 our design, development, and manufacturing processes to eliminate or reduce the possibility  
 21 of potential defects, from time to time, we discover product defects from either design or  
 22 manufacturing quality perspective. ***To date, we have not experienced any significant loss from such defects nor do we believe that defects discovered during this or previous quarters could cause orders for our products to be canceled or delayed, reduce revenue, or render our product designs obsolete.*** In that event, we would be  
 23 required to devote substantial financial and other resources for a significant period of time  
 24 in order to develop new product designs. We cannot assure you that we would be  
 25 successful in addressing any manufacturing or design defects in our products or in  
 26 developing new product designs in a timely manner, if at all. Any of these events,  
 27 individually or in the aggregate, ***could*** harm our business, financial condition and results of  
 28 operations.

\* \* \*

27                 A majority of our sales comes from a small number of customers; ***if*** we lose any of these  
 28 customers, our sales ***could*** decline significantly.

1           For the three and six months ended June 30, 2000, 53% and 92%, respectively,  
 2 of net sales came from 10 customers. Although the customer mix varies from quarter to  
 3 quarter, we are dependent upon continued revenue from our major customers. As a result,  
**any material delay, cancellation or reduction of orders from these major customers  
 could cause our sales to decline** significantly. Some of these customers individually  
 4 accounted for more than 10% of our net sales in the first half of 2000. **TriGem  
 InfoComm., Corp., Darwin Networks and I-Quest Corporation accounted for 33%,  
 14%, and 10%, respectively, of our net sales in the first half of 2000.** There is no  
 5 guarantee that we will be able to retain any of our major customers or any other accounts.  
 In addition, our customers may materially reduce the levels of services ordered from us at  
 6 any time. This could cause a significant decline in our net sales and we may not be able to  
 reduce the accompanying expenses at the same time.  
 7

8           69.     Reasons Why and Defendants' Knowledge that the Financial Results and Statements About  
 9 Product Defects Contained in the Form 10-Q Filed with the SEC on 7/27/00 Were Materially False and  
 10 Misleading: The financial results reported in the Form 10-Q were false and misleading for the reasons set  
 forth in ¶67.

11           (a)     Defendants knew the statement that manufacturing or design defects "could" harm  
 12 Tut's business and that the Company did not "believe that defects discovered during this or previous quarters  
 13 could cause orders for our products to be cancelled or delayed, reduce revenue or render our product  
 14 designs obsolete," was false and misleading. All of the Individual Defendants attended weekly staff meeting  
 15 where the product problems and recall were discussed. Tut had to stagger notifying its customers of the  
 16 recall because it did not have enough product to replace the defective product. Sales and customer support  
 17 were fighting over the new product. Thousands of Espresso System platforms were being returned  
 18 increasing Tut's supply of defective, obsolete and excess inventory. In short, manufacturing and design  
 19 defects **already had** harmed Tut's business.  
 20

21           (b)     Defendants also knew the statement that sales "could" decline significantly "if" Tut  
 22 lost any of its large customers cancelled or reduced orders was false and misleading because Trigem, the  
 23 Company's largest customer, would not be purchasing any product in 3Q00. Further, Tut's other large  
 24 customers (Darwin, I-Quest, CAIS Internet) were experiencing financial problems of their own and were  
 25 delinquent in paying their accounts.  
 26

27           (c)     Item 303 of SEC Regulation S-K, 17 C.F.R. 229.303(a)(3)(ii) required Tut to  
 28 describe any known trends or uncertainties that the registrant reasonably expected would have material  
 favorable or unfavorable impact on net sales or revenues or income from continuing operations.

1 Consequently, the product problems, recall, loss of Trigem and the delinquency of Tut's other customers  
2 were required to be disclosed.

16       70.     Defendants Sell Their Stock – Additional Circumstantial Evidence of Scienter: As a result  
17 of defendants' false positive statements Tut's stock price increased 26% from \$68.25 on 7/19/00 to  
18 \$86.3125 on 7/20/00. The Company's stock price continued to rise in 7/00 and 8/00 reaching a Class  
19 Period high of \$120.375 on 8/29/00. With full knowledge of the undisclosed product problems, recall, the  
20 loss of the Company's largest customer (Trigem) and the sham Reflex sales, each of the Individual  
21 Defendants suddenly sold their shares in unison during a narrow three week period from 8/1/00-8/24/00.  
22 Taking advantage of the Company's inflated stock price, defendants sold 188,100 shares, or 46.5% of their  
23 total available holdings for illegal insider trading proceeds of \$17 million. Many of the Individual Defendants  
24 sold their shares on the same day. The sales were at prices between \$83.13 and \$104.3, far in excess of  
25 the \$5.8438 price at which Tut stock traded at on 2/1/01.

26        71. On 8/24/00, following the huge increase in the price of the Company's stock and defendants'  
27 suspicious and coordinated sales (which were not yet publicly disclosed), Kaufman Bros. analyst Clifton  
28 Gray issued a report downgrading his rating on Tut's stock from "STRONG BUY" to "BUY." Gray

1 attributed the downgrade to concerns over valuation and the remaining upside left in the stock. Gray stated  
 2 that the Company's current valuation (Tut's market capitalization was nearly \$2 billion based on the  
 3 \$110.9375 closing price of the Company's stock on 8/23/00) demanded significant upside to estimates.

4       72.     In 9/00 and 10/00, the price of Tut's stock declined closing at \$51.875 on 10/17/00. In  
 5 addition to the valuation concerns reported by Clifton Gray on 8/24/00, several analysts attributed the  
 6 decline to broadband access equipment companies (Tut's competitors) preannouncing disappointing 3Q00  
 7 earnings and CLECs (Tut's customers) issuing earnings warnings and filing for bankruptcy.

8       73.     On 10/4/00, Jeffries & Company, Inc., analyst J.J. Bellace issued a report downgrading the  
 9 rating on Tut's stock from "Buy" to "Accumulate" due to the investment community's concerns about  
 10 financing problems recently disclosed by several CLECs and BLECs.

11      74.     On 10/6/00, Lehman Brothers analyst Steven Levy issued a report disclosing that some  
 12 CLECs had issued earnings warnings and declared bankruptcy and that some broadband access equipment  
 13 companies had preannounced disappointing 3Q00 earnings. Nevertheless, Levy reported that Tut was  
 14 expected to report impressive 3Q00 results on 10/18/00 and that international sales, particularly to Korea,  
 15 were expected to be an important source of revenue.

#### 16 **B. Defendants' False and Misleading Statements Regarding Tut's 3Q00 Financial Results**

17      75.     False Statement: On 10/18/00, Tut announced its 3Q00 results in a release which stated:  
 18           Tut Systems, Inc. More Than Triples Revenue  
 19           Tut Systems, Inc. today reported a strong third quarter performance with ***revenue for the***  
 20 ***quarter ended September 30, 2000, of \$28.6 million***, an increase of 246%, compared to revenue of \$8.3 million for the quarter ended September 30, 1999.

21           ***The net income for the quarter ended September 30, 2000, excluding certain***  
 22 ***noncash purchase acquisition expenses of \$2.5 million, was \$1.9 million, or \$0.11***  
 23 ***per share***, compared with a net loss for the quarter ended September 30, 1999, of \$(1.6)  
 million or \$(0.13) per share. Net loss for the quarter ended September 30, 2000, including noncash purchase acquisition expenses, was \$(0.6) million.

24           ***"We are very proud to announce yet another successful quarter – our fifth***  
 25 ***consecutive quarter of triple digit growth,"*** said Tut Systems, Inc. President and Chief  
 26 Executive Officer, Sal D'Auria. "Additionally, ***our revenue this quarter represented***  
***three times the revenue we reported a year ago – a great indication of our financial***  
***position and the demand for our product line.***

27           ***"Tut is also proud to announce today that we have shipped over 308,000***  
 28 ***lines and over 23,000 building systems to date to the multi-tenant unit (MTU)***  
***market,"*** said D'Auria. "And, with the upcoming launch of IntelliPOP MTU (TM), we feel

1           confident we can continue to widen our leadership position. The IntelliPOP platform based  
 2           on Tut's core technology, the Signature Switch (TM), empowers service providers to create  
 3           and control an unlimited array of services in multi-tenant environments – allowing them to  
 4           extract new value from their broadband investments. We expect that this dynamic product  
 5           line will help Tut continue to win in the MTU market."

6           The Company's financial results reported in the 10/18/00 press release were repeated to the market in  
 7           reports issued on 10/19/00 by Kaufman Bros. analyst Clifton Gray, Chase Hambrecht & Quist Inc., analyst  
 8           I. Grozovsky, Lehman Brothers analyst Steven Levy and Frost Securities analyst Syed Haider (copies of  
 9           these reports are attached to the Appendix and incorporated by reference).

10           76.       Reasons Why and Defendants' Knowledge that Their Statements Were False and  
 11           Misleading: The financial results and other positive statements contained in the 10/18/00 press release and  
 12           the 10/19/00 analyst reports were materially false and misleading for the reasons set forth in ¶¶67 and 69.  
 13           Defendants knew they were misleading the analysts into serving as conduits for distributing false information  
 14           to investors.

15           (a)       As detailed in ¶¶37-65, defendants knew the revenue and EPS numbers reported  
 16           for 3Q00 and the nine months ending 9/30/00 were materially overstated because Tut (1) improperly  
 17           recognized revenues on sales of defective products, (2) improperly recognized revenues on contingent sales,  
 18           (3) improperly recognized revenues on the undisclosed affiliate transaction with Reflex where collection was  
 19           not probable, (4) failed to establish adequate reserves for obsolete and excess inventory and (5) failed to  
 20           establish adequate reserves for uncollectible accounts receivables.

21           (b)       As detailed in ¶¶37-59, Tut improperly recognized revenues on sales of defective  
 22           product that was subject to a major recall and improperly recognized revenues on sales to its largest  
 23           customers that were not required to pay Tut until they had resold the product.

24           (c)       In addition to the product problems and recall detailed in ¶¶37-47, Tut's failure to  
 25           adequately reserve for obsolete, defective and excess inventory was reflected by another increase in net  
 26           inventory from \$15.4 million as of 6/30/00 to \$22.3 million as of 9/30/00. Despite the product problems,  
 27           recall and corresponding increase in inventory, Tut incurred a \$385,000 expense in 3Q00 to increase its  
 28           inventory reserve to \$1.9 million at 9/30/00. After the Class Period, Tut incurred more than \$48 million in  
 charges to reserve for obsolete, defective and excess inventory.

(d) As detailed in ¶¶62-65, Tut's failure to adequately reserve for uncollectible receivables was reflected by the further increase and deterioration of receivables. After receivables increased from \$11.7 million at 3/31/00 to \$15.4 million at 6/30/00, they doubled to \$30.6 million at 9/30/00. After DSOs increased to 67 days at 6/30/00, they rose further to 97 days at 9/30/00. However, the bad debt reserve, which was only increased by \$202,000 in 2Q00 to \$537,000, was only increased by \$6,000 to \$543,000 as of 9/30/00.

7 (e) As defendants knew from Tut's Aged Receivables Report, one of the reasons the  
8 level of receivables had increased and deteriorated was the failure of Darwin and Reflex (Tut's second and  
9 third largest customers in 2000) to pay Tut as required by the CPAs. Darwin, which Tut reported in its SEC  
10 filings had purchased \$5.2 million of product in the first six months of 2000 and \$2.7 million in 3Q00, had  
11 only paid Tut approximately \$1.5 million by 10/18/00. Reflex had not paid for any of the approximately \$7  
12 million of product purchased from Tut in 3Q00. Other customers were not paying due to the product  
13 problems and recall. After the Class Period, Tut incurred more than \$20 million in charges to increase the  
14 bad debt reserve to \$21.2 million as of 12/31/00. Approximately \$12 million of that amount related to the  
15 Darwin and Reflex accounts.

16 (f) Thus, contrary to the representation made in the 10/18/00 press release, defendants  
17 knew that Tut's revenue in 3Q00 misrepresented Tut's financial position and the demand for the Company's  
18 product line. When Tut finally accurately accounted for its inventory and receivables, Tut incurred more than  
19 \$91 million in charges to reserve or write-off (1) obsolete, defective and excess inventory (\$48 million), (2)  
20 uncollectible receivables (\$21 million), (3) cancelled purchase orders (\$19 million) and (4) the Company's  
21 equity investment in three customers including Reflex and Darwin (\$3.1 million).

22        77. Despite the positive false statements made by defendants in the 10/18/00 press release and  
23 the analyst reports issued on 10/19/00, the price of Tut's stock declined from \$51.875 on 10/17/00 to  
24 \$37.4375 on 10/18/00 and to \$31.1875 on 10/19/00. Tut led analysts and the financial press to believe  
25 that the price decline was the result of the announcement by one of Tut's competitors, Copper Mountain  
26 Networks, Inc., that it expected 4Q00 financial results to decline. However, Tut's financial problems were  
27 specific to the Company.

1       78. False Statement: On 11/14/00, Tut filed its 3Q00 Form 10-Q with the SEC. The Form 10-  
2 Q was signed by defendant Caldwell and repeated the financial results contained in the 10/18/00 press  
3 release and the analyst reports issued on 10/19/00. It was represented in the Form 10-Q that the financial  
4 statements contained therein reflected all adjustments necessary to present fairly the Company's financial  
5 position, results of operations and cash flows as of and for the three and nine months ending 9/30/00. The  
6 Form 10-Q also included the following representations:

Manufacturing or design defects in our products *could* harm our reputation and business.

8 Any defect or deficiency in our products ***could*** reduce the functionality,  
9 effectiveness or marketability of our products. These defects or deficiencies ***could*** cause  
10 orders for our products to be canceled or delayed, reduce revenue, or render our product  
designs obsolete. ***In that event***, we would be required to devote substantial financial and  
11 other resources for a significant period of time in order to develop new product designs.  
***We cannot assure you that we would be successful in addressing any  
manufacturing or design defects in our products or in developing new product  
designs in a timely manner, if at all.*** Any of these events, individually or in the  
12 aggregate, ***could*** harm our business, financial condition and results of operations.

13 || \* \* \*

14 A majority of our sales comes from a small number of customers; *if* we lose any of these customers, our sales could decline significantly.

The majority of our annual sales come from a small number of our customers. Our 10 largest customers accounted for 78% of net sales for the nine months ended September 30, 2000 and 62% of net sales in 1999. Because we are dependent upon continued revenue from our 10 largest customers, any material delay, cancellation or reduction of orders from these or other major customers could cause our sales to decline significantly. Trigem Infocomm, Inc., Reflex Communications, Inc. and Darwin Networks, Inc. accounted for 19%, 13% and 12%, respectively, of our net sales for the nine months ended September 30, 2000. Rycom CCI, Inc. accounted for more than 10%, respectively, of our annual net sales in 1999. There is no guarantee that we will be able to retain any of our 10 largest customers or any other accounts. In addition, our customers may materially reduce the levels of services ordered from us at any time. This could cause a significant decline in our net sales and we may not be able to reduce the accompanying expenses at the same time.

79. Reasons Why and Defendants' Knowledge that the Financial Results and Statements About  
Product Defects Contained in the Form 10-Q Filed with the SEC on 11/14/00 Were Materially False and  
Misleading: The financial results reported in the Form 10-Q were false and misleading for the reasons set  
forth in ¶¶67, 69 and 76.

28 (a) Defendants knew the statement that manufacturing or design defects "could" harm  
27  
Tut's business was false and misleading. All of the Individual Defendants attended weekly staff meetings

1 where the product problems and recall were discussed. Tut had to stagger notifying its customers of the  
 2 recall because it did not have enough product to replace the defective product. Sales and customer support  
 3 were fighting over the new product. Thousands of Espresso System platforms were being returned  
 4 increasing Tut's supply of defective, obsolete and excess inventory. In short, manufacturing and design  
 5 defects ***already had*** harmed Tut's business.

6                         (b) Defendants also knew the statement that sales "could" decline significantly "if" Tut  
 7 lost any of its large customers cancelled or reduced orders was false and misleading because Trigem, the  
 8 Company's largest customer, would not be purchasing any product in 3Q00. Further, Tut's other large  
 9 customers (Darwin, I-Quest, CAIS Internet) were experiencing financial problems of their own and were  
 10 delinquent in paying their accounts.

11                         (c) Item 303 of SEC Regulation S-K, 17 C.F.R. 229.303(a)(3)(ii) required Tut to  
 12 describe any known trends or uncertainties that the registrant reasonably expected would have material  
 13 favorable or unfavorable impact on net sales or revenues or income from continuing operations.  
 14 Consequently, the product problems, recall, loss of Trigem and the delinquency of Tut's other customers  
 15 were required to be disclosed.

16                         (d) Further, contrary to GAAP, as set forth in FASB SFAS No. 57, Tut failed to  
 17 disclose the affiliate transaction with Reflex. GAAP, as set forth in SFAS No. 57, requires that financial  
 18 statements include disclosures of material related party transactions. According to SFAS No. 57, ¶2, these  
 19 disclosures must include the nature of the relationship involved, a description of transactions, the dollar  
 20 amount of transactions for each of the periods for which income statements are presented and the amounts  
 21 due from related parties as of the balance sheet date. A related party includes affiliates, principal owners  
 22 of an enterprise, its management, or other parties with which the enterprise may deal if one party controls  
 23 or can significantly influence the management or operation policies of the other. A party is also a related  
 24 party if it can significantly influence the management or operating policies of the transacting parties or if it has  
 25 an ownership interest in one of the transacting parties. See SFAS No. 57, ¶24(f).

26 **C. Defendants' False and Misleading Statements Regarding Tut's Revised Guidance for**  
**27 4Q00 Financial Results**

28

1       80.     False Statement: On 11/30/00, Tut announced that it expected 4Q00 revenues to be only  
 2 \$15-\$18 million rather than the \$35+ million defendants had led the market to expect. The press release  
 3 issued in connection with the announcement stated in part:

4              Tut Systems, Inc., a leading provider of multi-service broadband systems for multi-  
 5 tenant buildings, today reported that it expects financial results for the quarter ending  
 6 December 31, 2000 to be lower than consensus estimates ***due to various factors,  
 including tightening in the capital markets, which have affected some of Tut's  
 service provider customers.***

7              Based on currently available information, the company is targeting revenue of  
 8 between \$15 million and \$18 million for the fourth quarter of 2000. Additional guidance  
 9 and information will be discussed in a conference call scheduled for later today. After  
 10 today's conference call, Tut will not report on the progress of the quarter until actual results  
 11 are announced.

12       81.     This was a shocking surprise to the market. As a result, Tut's stock price collapsed to  
 13 below \$10 per share.

14       82.     Reasons Why and Defendants' Knowledge that the Statements Made in the 11/30/00 Press  
 15 Release Were Materially False and Misleading: The statements made by defendants in the 11/30/00 press  
 16 release were materially false and misleading for the reasons set forth in ¶¶67, 69, 76, 79. Specifically,  
 17 defendants failed to disclose (1) the product problems and recall, (2) the fact that Tut's earnings were  
 18 materially overstated due to the Company's failure to establish adequate reserves for uncollectible  
 19 receivables and obsolete, defective and excess inventory, and (3) that revenues were materially overstated  
 due to Tut's practice of improperly recognizing revenues on contingent sales, sales of defective product and  
 sales to related parties.

20       83.     Subsequent to the 11/30/00 disclosure, Tut hosted a conference call on 11/30/00 to discuss  
 21 its business and prospects in light of this disclosure. Based on Tut management's statements to analysts,  
 22 including on the 11/30/00 conference call, analysts wrote reports about Tut and its prospects. These reports  
 23 were consistent with and repeated management's false and misleading statements, which statements had been  
 24 made to the analysts with the intention they would be repeated to the market.

25       84.     False Statement: On 11/30/00, Kaufman Bros. issued a report on Tut by Clifton Gray,  
 26 which stated in part:

27              Tut Systems preannounced results for the fourth quarter, slashing its previous  
 28 estimates. The company is now expecting sales during the quarter to be between \$15 and  
 \$18 million. This is a more than 50% decrease versus our prior estimate of \$36 million. On

its conference call the company stated that its customers are very concerned about the availability of funding from the capital markets and they have decided to scale back their service deployments and focus on properties with the most favorable prospects. End customer demand has not slowed, but service providers have become much less aggressive in their deployment plans due to real and potential funding issues.

In addition, revenues from Korea will not likely rebound in the March period as previously expected; instead ***we believe Korea will begin to pick up again towards the summer of 2001.*** While we did not expect Korea to account for any significant portion of the growth in coming quarters, the apparent weakness in this area makes reacceleration for Tut's total business that much more difficult.

*The company was also unwilling to answer any questions regarding aging receivables.* Highlighting this problem, Tut cited one major customer, which is cash flow positive, who has asked for a payment plan from Tut in order to conserve capital. *While the company maintains its customers are all in solid financial condition, this latest development certainly highlights the difficulties associated with negative cash flow businesses in this market.* Because of these difficulties, we believe some aging receivables from certain customers could be at risk. If the company does not receive payment from these customers it will likely have to restate sales from those accounts.

85. False Statement: On 12/01/00, Lehman Brothers issued a report on Tut by Steven Levy which stated:

Citing a precipitous drop in visibility in the last two weeks relating almost totally to its domestic carrier customers, ***Tut is now anticipating 4Q revenues to fall within a range of \$15-18 million and a pro forma EPS loss between \$0.27-\$0.36 cents.*** We had previously been forecasting revenues of \$35.5 million and EPS of \$0.19. Based on this surprising development we have lowered our projections for 4Q to \$16 million in revenues and a loss per share of \$0.32. Although we find this news rather disappointing, it is our opinion that the fundamental drivers, namely Tut's unique business plan and strong management team, remain in place. Although we are lowering our 12-month price target to \$25, we are reiterating our 1 Buy rating because of the company's asset value (see below). We further believe that Tut is capable of weathering any short-term problems and should be able to deliver strong quarterly performance once the capital markets for its customer base becomes more friendly.

*Accounts receivables days sales outstanding, DSO's, ramped up at the end of 3Q because nearly 70% of the quarter's sales were booked in the last 45 days of the quarter.* Tut had hoped to bring that number down in 4Q, but this now seems unlikely given the financial state of affairs on the BLEC front. *While management indicated only one of its customers had negotiated plans to postpone payment, they hinted that additional customers could seek more favorable payment plans in the near future, although none have made the request so far.* Thus, DSO's at the end of December are likely to come in at a higher level than the 74 days registered at the end of 3Q, according to our calculations. *An additional note of importance on the balance sheet is inventories, which should also see an increase during fiscal 4Q.* Tut had been anticipating robust demand for its products throughout the end of year, but the sudden slowdown in the MTU market should leave the company with higher than normal inventory levels for the fiscal fourth quarter. The inventories are not likely to go stale and should not be a source of concern, in our view.

1           86.     Defendants' Knowledge of and Reasons Why the Statements Repeated to the Market by  
 2 the Analysts were False and Misleading: The statements by defendants that were repeated to the market  
 3 through the analysts were false and misleading for the reasons set forth in ¶82. Defendants knew they were  
 4 misleading the analysts into serving as conduits for distributing false information to investors.

5               (a)    Defendants continued to conceal the product problems, recall and financial  
 6 deterioration at Tut. Nothing was revealed about the recall. As reported by Kaufman Bros. analyst Gray,  
 7 the Company refused to answer questions regarding aging receivables and maintained that its customers  
 8 were all in solid financial condition. Defendants knew that Tut's customers were not in solid financial  
 9 condition but were delinquent in paying their accounts. Defendants knew the Darwin and CAIS accounts  
 10 were "on hold," and that Reflex had not, and would not, pay for any of the product shipped to them in  
 11 3Q00. Defendants also knew that customers were not paying for defective product that was subject to the  
 12 recall.

13               (b)    Defendants knew the statement repeated by Lehman Brothers analyst Levy that  
 14 "only one of [Tut's] customers had negotiated plans to postpone payment" was false and misleading because  
 15 many of Tut's customers were not paying their bills due to their own financial problems or because they were  
 16 shipped defective product.

17               (c)    Defendants knew that 4Q00 revenues would not be \$15-\$18 million and that the  
 18 pro forma EPS loss would not be between \$0.27 and \$0.36 as reported by Lehman Brothers analyst Levy.  
 19 Defendants knew Tut's revenues would be much lower due to the financial difficulties of its customers, the  
 20 loss of Trigem as a customer and the problems with Tut's products. Defendants knew that Tut would have  
 21 to incur millions of dollars in charges in 4Q00 to reserve for uncollectible receivables and worthless  
 22 inventory.

23           87.     False Statement: On 1/8/01, Tut issued a release that stated:

24               Tut Systems, Inc., a leading provider of multi-service broadband systems for multi-  
 25 tenant buildings, today reported that it expects financial results for the quarter ending  
 December 31, 2000 to be lower than previously anticipated. Tut had previously anticipated  
 26 revenues for the quarter in the range of \$15-18 million. As a result of continuing adverse  
 developments in the telecommunications industry, the company expects revenues for the  
 27 quarter to be in the range of \$6-7 million. ***The company cited rescheduling of orders***  
***and additional curtailing of credit availability as key reasons for the downturn.***  
 28 The company is in the process of completing its quarterly close and as a result, earnings per  
 share numbers are not available. However, in light of increased risks, ***the company***

1           *anticipates that it will record significant additional balance sheet reserves  
2 including those related to allowances for doubtful accounts. The reserves have not  
3 yet been quantified.*

4           88. Defendants' Knowledge and Reasons Why the 1/8/01 Press Release Was False and

5           Misleading: The statements made by defendants in the 1/8/01 press release were false and misleading for  
6 the reasons set forth in ¶82. Tut's financial decline was a function of Company specific problems.

7           (a)       Although the Company stated that it would record significant additional balance  
8 sheet reserves related to allowances for doubtful accounts, it continued to conceal the product problems and  
9 recall and the millions of dollars in reserves that would be required for worthless inventory. Further, while  
10 the Company stated the reserves had not yet been quantified, defendants knew that Tut would be reserving  
11 for practically all of its receivables. Defendants knew that Reflex and Darwin were delinquent and would  
12 not pay Tut approximately \$12 million due to their financial problems. Defendants knew Reflex had not paid  
13 for any of the approximately \$7 million of product shipped to Reflex in 3Q00 and that Reflex had not even  
14 used any of the product.

15           (b)       Defendants also knew, but concealed, that Tut would incur additional expenses to  
16 reserve for its stock investments in Reflex and Darwin. Indeed, Darwin would declare bankruptcy just three  
17 days later on 1/11/01. Defendants knew Tut would be required to write-off its investment in Reflex  
18 preferred stock which it had purchased just months earlier in 7/00 when Reflex was shipped approximately  
19 \$7 million of product.

20           **DEFENDANTS' SCHEME UNRAVELS**

21           89.       On 1/31/01, Tut shocked the market once again by announcing that in addition to the  
22 receivables problems, Tut had taken a \$29.3 million charge for overvalued inventory and purchase  
23 commitments. The press release issued in connection with the announcement stated in part:

24           Tut Systems, Inc. today announced its results for the fourth quarter of 2000.  
25           ***Revenue for the quarter ended December 31, 2000 was \$5.9 million,*** compared to  
26 revenue of \$10.6 million for the quarter ended December 31, 1999.

27           ***The net loss for the quarter ended December 31, 2000,*** excluding certain  
28 noncash purchase acquisition expenses of \$2.5 million, ***was \$(65.5) million, or \$(4.12)  
per share,*** compared with a net loss for the quarter ended December 31, 1999, of \$(1.5)  
million or \$(0.13) per share. Net loss for the quarter ended December 31, 2000, including  
noncash purchase acquisition expenses, was \$(68.0) million.

1           The foregoing results and other financial matters discussed herein are the preliminary  
 2 actual results for the quarter. Tut's auditors have not yet completed their review of the  
 3 financial statements in connection with the annual audit. The audit could result in  
 4 adjustments to the preliminary results announced today.

5           Continuing adverse developments affecting the telecommunications industry have  
 6 affected the current financial condition of certain Tut customers. As a result, ***Tut has***  
***increased its allowance for doubtful accounts by approximately \$22.1 million*** which  
 7 is reflected in general and administrative expenses. ***In a related move, Tut recorded a***  
***\$3.1 million loss to reflect the estimated impairment of the value of its equity***  
***investments in certain customers. Tut also added a provision for loss on purchase***  
***commitments and abandoned products of \$29.3 million which reflects its decision***  
***to reduce future inventory manufacturing commitments and to exit certain noncore***  
***product lines.*** Tut also disclosed that included in the balance sheet at December 31, 2000  
 8 is a short-term investment of \$9.2 million in commercial paper issued by Southern California  
 9 Edison Company which is currently in default. Tut believes that the ultimate realization of  
 10 this investment is not currently determinable. Including this investment, Tut had a cash, cash  
 equivalent and short term investment position of approximately \$102.6 million at December  
 31, 2000.

11          To operate more efficiently, ***Tut will reduce its work force by 10% effective***  
 12 ***immediately*** and announced that the company's marketing and engineering employees will  
 13 report to Mark Carpenter, Vice President of Products, and Ian Moir, Vice President of  
 14 Technology.

15          ***Tut also announced that Tom Warner, Vice President of Engineering and***  
 16 ***Matt Taylor, Chief Technical Officer and Board Member, have left the company***  
 17 ***to pursue other interests.***

18          90.       After this news, Tut's stock dropped to below \$6 per share and has continued to decline  
 19 since that time, falling to below \$2 per share in late 6/01, as investors have become increasingly aware of  
 20 how poor Tut's prospects are and its past results actually were.

#### 19           **POST CLASS PERIOR EVENTS FURTHER DEMONSTRATING 20 DEFENDANTS' FRAUD**

21          91.       Even with the revised guidance issued by the Company in 11/00 and 1/01, analysts were  
 22 stunned by the disastrous results announced on 1/31/01. J.P Morgan H&Q analyst Michael Nieberg  
 23 reported that the December quarter was "dismal" and a "train wreck." Nieberg immediately slashed 2001  
 24 revenue and EPS estimates. Kaufman Bros. analyst Gray reported that Tut was "crippled" and that the  
 25 future would be "treacherous" for the Company. Gray downgraded Tut shares from "ACCUMULATE" to  
 "HOLD." Frost Securities analyst Syed Haider questioned whether Tut had been mortally wounded.

26          92.       Despite the horrible financial results, the analysts did note that Tut was still well capitalized,  
 27 had no debt and reported cash and cash equivalents of approximately \$100 million which equated to

1 approximately \$6 per share. However, in the first three quarters of 2001, Tut reported a \$97.8 million net  
 2 loss that reduced the Company's cash and cash equivalents to approximately \$56 million.

3       93.     In every quarter since the end of the Class Period, Tut has reported declining revenues,  
 4 additional and substantial charges to reserve for obsolete and excess inventory, and massive losses.

	<u>1Q01</u>	<u>2Q01</u>	<u>3Q01</u>	<u>4Q01</u>
6 Revenues	\$4,887	\$2,722	\$3,967	\$2,172
7 Net Income	(\$33,969)	(\$13,999)	(\$49,382)	(\$6,526)
8 EPS	(\$2.10)	(\$0.86)	(\$3.05)	(\$0.40)
9 Provisions for Inventories	\$18,633	\$3,244	\$11,425	N/A

10       94.     Moreover, after improperly recognizing revenues in violation of GAAP on sales to customers  
 11 where collectibility was not probable, the Company disclosed in 2001 that it was now deferring revenue  
 12 recognition on sales to customers where collection was uncertain due to customers requesting extended  
 13 payment terms. On 4/9/01 Tut announced it had shipped more than \$5.7 million in product in 1Q01 but  
 14 would not be recognizing revenues on all shipments because collection was uncertain. The Company also  
 15 disclosed it would host a conference call on 4/18/01 to discuss 1Q01 results.

16       95.     On 4/17/01 Tut postponed the conference call from 4/18/01 to 4/23/01. On 4/23/01, Tut  
 17 again postponed the conference call to 5/10/01 and announced another reduction in force. After announcing  
 18 a 10% reduction on 1/31/01, Tut disclosed another 28% of the Company's workforce would be let go.

19       96.     On 5/10/01, Tut finally announced 1Q01 revenues of \$4.9 million and a net loss of \$34  
 20 million or a \$2.10 loss per share. On 5/11/01, Lehman Brothers analyst Andrea Green reported Tut's 1Q01  
 21 financial results were "clearly disappointing" and that Tut had deferred revenues related to some new  
 22 customers as well as customers requesting extended payment terms. J.P. Morgan analyst Michael Neiberg  
 23 noted Tut's "alarming cash burn of \$26 million" in the quarter.

24       97.     On 8/1/01 Tut announced that 2Q01 revenues had actually declined from 1Q01 to \$2.7  
 25 million and that defendant Caldwell had resigned for personal reasons. The Company reported a net loss  
 26 for the quarter of \$14 million or (\$0.86) EPS. Unlike the Company's 1Q01 earnings release, the 8/1/01  
 27 earnings release did not disclose that Tut had deferred revenue recognition in 2Q01. However, Lehman  
 28

1 Brothers analyst Andrea Green reported the Company did not recognize \$1 million of shipments as revenue  
 2 due to customers' financial difficulties.

3       98.      On 10/31/01 Tut announced another dismal quarter reporting revenues of \$3.9 million and  
 4 a net loss of \$49.8 million or (\$3.05) EPS. The accumulated deficit increased to \$228.4 million.

5       99.      On 1/31/02 Tut announced horrible 4Q01 and F01 results. Revenues in 4Q01 were \$2.2  
 6 million and the net loss was \$6.5 million or (\$0.40) EPS. For F01, Tut's net loss was a staggering \$104.3  
 7 million or (\$6.39) EPS.

8       100.     In 1/99 and 3/00 Tut raised approximately \$188 million from public investors. In the almost  
 9 three year period since Tut went public in 1/99, the Company has never reported a profit and has lost more  
 10 than \$190 million. Tut's stock price has not recovered and currently trades at less than \$2 per share.

11           **TUT'S FALSE FINANCIAL REPORTING DURING THE CLASS PERIOD**

12       101.     Tut's results in 2Q00 and 3Q00 were materially false and misleading. Defendants caused  
 13 Tut to report inflated financial results during the Class Period by (1) improperly recognizing revenues on  
 14 sales of defective product, (2) improperly recognizing revenues on contingent sales to its largest customers  
 15 including Trigem, Darwin and Reflex, (3) failing to adequately reserve for uncollectible receivables and (4)  
 16 failing to adequately reserve for obsolete, defective and excess inventory. The fact that Tut has incurred  
 17 more than \$91 million of charges to reserve for uncollectible accounts receivables, inventories, equity  
 18 investments in customers and cancelled purchase orders is essentially an admission that the results as  
 19 originally reported were materially false and in violation of GAAP.

20       102.     GAAP are those principles recognized by the accounting profession as the conventions, rules  
 21 and procedures necessary to define accepted accounting practice at a particular time. SEC Regulation S-X  
 22 (17 C.F.R. §210.4-01(a)(1)) states that financial statements filed with the SEC which are not prepared in  
 23 compliance with GAAP are presumed to be misleading and inaccurate, despite footnote or other disclosure.  
 24 Regulation S-X requires that interim financial statements must also comply with GAAP, with the exception  
 25 that interim financial statements need not include disclosure which would be duplicative of disclosures  
 26 accompanying annual financial statements. 17 C.F.R. §210.10-01(a).

27

28

1     **A. Tut's Improper Revenue Recognition and Failure to Adequately Reserve for Accounts  
2        Receivable with Doubtful Collectibility**

3        103. Pursuant to GAAP, as set forth in FASB Statement of Concepts No. 5 and SOP 97-2, and  
4        Tut's publicly reported revenue recognition policy, revenues could not be recognized unless all of the  
5        following criteria are met: (1) persuasive evidence of an arrangement exists, (2) delivery has occurred, (3)  
6        the fee is fixed and determinable, and (4) collectibility is probable.

7        104. Further, pursuant to GAAP as set forth in SFAS No. 48, revenues can not be recognized  
8        at the time of sale where the buyer has the right to return the product unless (1) the price is substantially fixed  
9        or determinable at the time of sale, (2) the buyers payment obligation is not contingent on resale, (3) the  
10      amount of future returns can be reasonably estimated.

11       105. Defendants knew collectibility of the revenues recognized during the Class Period was not  
12       probable due to the product problems and recall. Defendants also knew that collectibility was not probable  
13       due to the financial problems confronting its largest customers including Darwin and Reflex whose accounts  
14       were delinquent during the Class Period. Indeed, Darwin declared bankruptcy on 1/11/01 and Reflex  
15       declared bankruptcy on 3/28/01. Further, defendants knew that contrary to the terms of the CPAs, Tut's  
16       largest customers were not required to pay for product until resale and that Tut's customers had the right  
17       to return unsold product.

18       106. GAAP, as set forth in FASB Statement of Financial Accounting Standards ("SFAS") No.  
19       5, *Accounting for Contingencies*, states that any loss to be expected from an uncollectible receivable  
20       should be accrued when it is probable and when the amount of such loss can be reasonably estimated. See  
21       SFAS No. 5, ¶8. According to SFAS No. 5, ¶22:

22       Losses from uncollectible receivables shall be accrued when both conditions in paragraph  
23       8 are met [the loss is probable and the amount of loss can be reasonably estimated]. Those  
24       conditions may be considered in relation to individual receivables or in relation to groups  
25       of similar types of receivables. If the conditions are met, accrual shall be made even though  
26       the particular receivables that are uncollectible may not be identifiable.

27       107. In violation of GAAP, Tut failed to make timely and adequate accrual for uncollectible  
28       receivables despite knowing the following:

29           (a)       Receivables had increased 48% in the 2Q00, even though sales increased only 27%.

(c) Customer Darwin was having trouble paying bills in 7/00 and failed to pay Tut \$5.0 million. Despite getting some financing from Cisco in 10/00, Darwin filed bankruptcy in 1/01.

5 (d) Customer Reflex failed to pay Tut for any of the approximately \$7 million of product  
6 shipped to Reflex in 3Q00 and filed for bankruptcy in 3/01.

7 (e) Customer I-Quest was an Asian firm which focuses on installing equipment in high-  
8 end hotels targeting mainly business travelers needing broadband Internet access. However, I-Quest was  
9 responsible for paying for investments in the infrastructure and had to rely on usage fees to provide cash.  
10 Prior to the 4/00 collapse in technology-related stocks, I-Quest had planned a public offering. Upon the  
11 collapse, I-Quest was forced to rethink this plan and its funding was much more precarious.

12 (f) CAIS Internet, a delinquent Tut customer whose account was "on hold" by 9/00  
13 due to nonpayment, suffered through increasing losses and liabilities and minimal revenue in 2000:

	4Q99	1Q00	2Q00	3Q00	
14					
15	Revenues	\$4.68M	\$6.87M	\$8.65M	\$11.1M
16	Losses	\$23.7M	\$24.7M	\$41.3M	\$36.1M
17	Liabilities	\$59.6M	\$72.3M	\$99.1M	\$153.4M

## 23 B. Tut's Improper Accounting for Inventory

24        108. GAAP, as set forth in Accounting Research Bulletin (“ARB”) No. 43, Chapter 4, *Inventory*  
25 *Pricing*, requires that inventories be recorded at the lower of cost or market. ARB No. 43, Chapter 4,  
26 Statement 5, states:

A departure from the cost basis of pricing the inventory is required when the utility of the goods is no longer as great as its cost. Where there is evidence that the utility of goods, in their disposal in the ordinary course of business, will be less than cost, whether due to

1           physical deterioration, obsolescence, changes in price levels or other causes, the difference  
 2           should be recognized as a loss in the current period. This is generally accomplished by  
 3           stating such goods at a lower level commonly designated as *market*.

4 (Emphasis in original.)

5           109. During the Class Period, the Company recalled Espresso System Platforms due to design  
 6           and manufacturing defects that caused the systems to overheat and fail. Further, the Company suffered from  
 7           diminishing demand for its products. The foregoing resulted in Tut accumulating millions of dollars worth  
 8           of excess inventory and liabilities associated with non-cancellable purchase commitments. In fact, Tut had  
 9           excess inventory in the channel and many of its sales were generated through sales to non-creditworthy  
 10          customers. Pursuant to GAAP, the Company was required to evaluate its inventory at each quarter-end  
 11          and record losses for the excessive inventory Tut held. However, in order to meet their own aggressive  
 12          earnings estimates, the Individual Defendants caused the Company to not take adequate reserves for excess  
 13          and overvalued inventory.

14           110. Ultimately, in the 4Q00 (a quarter subject to audit by Tut's independent auditors) Tut  
 15          admitted that as part of its write-down of assets, it had incurred (1) a \$19 million charge related to cancelled  
 16          purchase orders, (2) an \$8.2 million charge related to the Company's decision to abandon further  
 17          development and sale of certain product lines, (3) a \$6.3 million charge to reserve for excess and obsolete  
 18          inventory, and (4) a \$1.1 million charge to write-off inventory. All of the charges except the \$19 million  
 19          charge caused Tut's reserve for obsolete and excess inventory to increase from \$1.9 million at 9/30/00 to  
 20          \$13.8 million at 12/31/00.

20	Inventory Reserve at 12/31/99	\$418
21	Provisions added in 1Q00-3Q00	\$1,475
22	Provisions added in 4Q00	\$12,993
23	Inventory write-off	(\$1,131)
24	Inventory Reserve at 12/31/00	\$13,755

25           111. In the first three quarters of 2001, the Company has incurred \$33.3 million of additional  
 26          charges and increased the reserve for obsolete and excess inventory to approximately \$47 million.

27           112. Thus, after the Class Period, Tut incurred approximately \$65 million in charges related to  
 28          defective, obsolete and excess inventory. The magnitude of the inventory related charges alone confirms

1 that defendants caused Tut to materially overstate inventory and earnings throughout the Class Period. Had  
 2 Tut adequately reserved for excess, obsolete and defective inventory during the Class Period, such massive  
 3 charges would have been unnecessary.

4 **INSIDER TRADING**

5       113. As alleged herein, defendants acted with scienter in that defendants *had actual knowledge*  
 6 that the public documents and statements issued or disseminated in the name of the Company were  
 7 materially false and misleading; knew that such statements or documents would be issued or disseminated  
 8 to the investing public; and knowingly and substantially participated in the issuance or dissemination of such  
 9 statements or documents as primary violations of the federal securities laws. As set forth elsewhere herein  
 10 in detail, defendants, by virtue of their receipt of information reflecting the true facts regarding Tut, their  
 11 control over and/or receipt and/or modification of Tut's allegedly materially misleading statements and/or  
 12 their associations with the Company which made them privy to confidential proprietary information  
 13 concerning Tut, participated in the fraudulent scheme alleged herein. This scheme: (a) deceived the investing  
 14 public regarding Tut's business, product capabilities, financial results, demand, growth, operations and the  
 15 intrinsic value of Tut securities; and (b) allowed Company insiders, several of whom are named as  
 16 defendants herein, to sell 188,100 shares of their Tut securities during the Class Period, while in possession  
 17 of materially adverse, undisclosed information, allowing them to reap illicit proceeds of at least \$17.1 million  
 18 and to profit from the artificial inflation in the price of Tut stock which their scheme had created. The scheme  
 19 also caused plaintiffs and other members of the class to purchase or otherwise acquire Tut securities in a  
 20 market in which the price of Tut securities was artificially inflated.

21       114. Defendants' insider sales, while not necessary to establish their scienter in this case, are  
 22 clearly probative of their knowledge and strengthen the already strong inference of scienter which is the  
 23 result of their actual knowledge of the falsity of their statements.

24       115. As Tut stock increased in price due to the false positive statements about Tut's business  
 25 detailed herein, Tut insiders took advantage of this artificial inflation in Tut's stock price by selling the  
 26 following amounts of Tut stock:

27

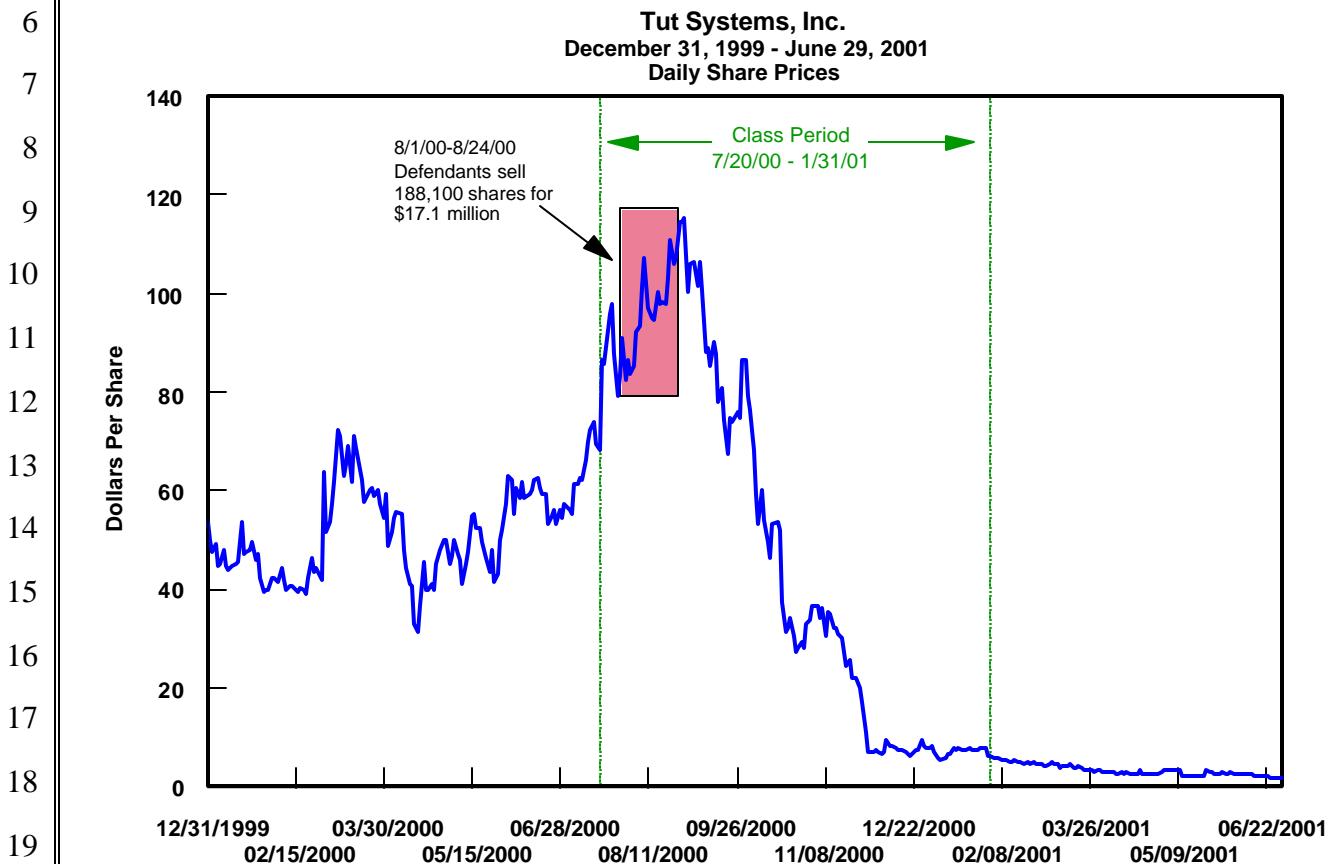
28

	<b>Insider</b>	<b>Date</b>	<b>Shares</b>	<b>Price</b>	<b>Value</b>
1	Benett	08/04/00	3,000	\$83.13	\$249,390
2		08/04/00	2,000	\$83.25	\$166,500
3		<b>Totals:</b>	<b>5,000</b>		<b>\$415,890</b>
4	Caldwell	08/01/00	11,400	\$88.00	\$1,003,200
5		08/17/00	6,800	\$100.00	\$680,000
6		08/18/00	1,000	\$99.00	\$99,000
7		<b>Total:</b>	<b>19,200</b>		<b>\$1,782,200</b>
8	D'Auria	08/01/00	15,000	\$87.08	\$1,306,200
9		08/15/00	15,000	\$94.29	\$1,414,350
10		08/21/00	17,600	\$98.09	\$1,726,384
11		08/22/00	7,500	\$104.13	\$780,995
12		<b>Total:</b>	<b>55,100</b>		<b>\$5,227,929</b>
13	Purdy	08/03/00	5,000	\$85.03	\$425,156
14		08/08/00	300	\$95.50	\$28,650
15		08/24/00	1,477	\$103.75	\$153,239
16		08/24/00	2,023	\$85.01	\$171,981
17		<b>Total:</b>	<b>8,800</b>		<b>\$779,026</b>
18	Taylor	08/01/00	50,000	\$86.54	\$4,327,050
19		08/02/00	25,000	\$85.13	\$2,128,275
20		08/17/00	25,000	\$98.90	\$2,472,500
21		<b>Total</b>	<b>100,000</b>		<b>\$8,927,825</b>
22		<b>TOTALS:</b>	<b>188,100</b>		<b>\$17,132,870</b>

116. Defendants sales as a percentage of their stock and vested options were as follows:

	<u>Defendant</u>	<u>Total Holdings</u>	<u>Sales</u>	<u>% of Holdings Sold</u>
23	D'Auria	215,917	55,100	25.5%
24	Caldwell	25,808	19,200	74.4%
25	Purdy	30,686	8,800	28.7%
26	Taylor	119,973	100,000	83.4%
27	Benett	11,890	5,000	42.1%
28	Total	404,274	188,100	46.5%

1       117. The timing of defendants' sales was particularly suspicious. All of the Individual Defendants  
2 sold stock in unison during a narrow three week period when Tut's stock traded at its all time high. Further,  
3 the coordinated sales occurred when defendants knew about the product problems and recall, the loss of  
4 Trigem (the Company's largest customer) and the sham sales to Reflex.



21        118. The timing of defendants' trading practices are so suspicious that one of the leading financial  
22 information analysts, Thomson Financial Network, ranks defendants as "all-star" inside traders. Thomson  
23 conducts extensive statistical analysis of the sales by insider and ranks insider sales by the price changes that  
24 occur after each insider's trade. This ranking information is accessible over the internet at  
25 <http://insider.thomsonfn.com/tfn/insider.asp>. Thomson's analysis demonstrates that defendants' trades are  
26 suspicious in that the price of the stock, on average, drops dramatically after defendants' sales. Thomson's  
27 analysis suggests that defendants' trading has historically occurred at very suspicious times – immediately

1 preceding a decline in the price of Tut Systems – exactly what occurred in this case – suggesting either  
 2 incredibly lucky timing or the systematic use of insider information when trading.

3 **Statistical Evidence of Scienter**

4       119. Plaintiffs hereby incorporate the contents of the Declaration of Scott D. Hakala, Ph.D.,  
 5 CFA, attached hereto ("Hakala Decl."), an expert in security market econometrics. Mr. Hakala is a  
 6 principal at Business Valuation Services ("BVS"), a national business valuation and consulting firm that  
 7 operates as a wholly owned subsidiary of Century Business Services, Inc., a publicly traded business  
 8 services firm (Nasdaq: CBIZ). Mr. Hakala received a doctor of philosophy degree in economics and a  
 9 bachelors degree in economics from the University of Minnesota, and earned the professional designation  
 10 Chartered Financial Analyst ("CFA"), awarded by the Association for Investment Management and  
 11 Research.

12       120. Dr. Hakala has shown through scientific method that defendants' sales were based on the  
 13 possession and use of inside information. According to Dr. Hakala, the stock sales are statistically  
 14 associated with the bad news ("subsequent adverse disclosures") revealed to investors. Dr. Hakala is an  
 15 expert in the fields of financial statistics. According to Dr. Hakala, there is less than 1 chance in 100 that  
 16 defendants traded in the manner they did independent of the possession and use of material, adverse non-  
 17 public information. In other words, Dr. Hakala's study concluded that the probability that defendants traded  
 18 on inside information is greater than **99%**. This level of certainty far exceeds the scientific acceptance  
 19 standard (95%), plaintiffs' civil standard of proof, and plaintiffs' pleadings burden.

20       121. A similar result obtains if each of the Individuals Defendants are analyzed separately. Under  
 21 this analysis, Dr. Hakala demonstrated that there was less than 1 in **100** chance that D'Auria, Caldwell,  
 22 Purdy, Taylor and Bennett traded in the manner that they did absent the possession and use of material inside  
 23 information. Hakala Decl., ¶6. These results are summarized in the following chart:

Defendant	Confidence Level Associated with Test of Independence	Threshold for Statistical Significance	Meets Standard for Inferring Association of Insider Sales with Subsequent Adverse Disclosure
D'Auria	>.99	.95	Yes

Defendant	Confidence Level Associated with Test of Independence	Threshold for Statistical Significance	Meets Standard for Inferring Association of Insider Sales with Subsequent Adverse Disclosure
Caldwell	>.99	.95	Yes
Purdy	>.99	.95	Yes
Taylor	>.99	.95	Yes
Benett	>.99	.95	Yes
Defendants as a Group	>.99	.95	Yes

As such, plaintiffs' pleading burden for scienter is met *per se*.

### CLASS ACTION ALLEGATIONS

122. This is a class action on behalf of purchasers of Tut securities during the Class Period, excluding defendants (the "Class"). Excluded from the Class are officers and directors of the Company, as well as their families and the families of the defendants. Class members are so numerous that joinder of them is impracticable.

123. Common questions of law and fact predominate and include whether defendants: (i) violated the 1934 Act; (ii) omitted and/or misrepresented material facts; (iii) knew or recklessly disregarded that their statements were false; and (iv) artificially inflated Tut's stock price and the extent of and appropriate measure of damages.

124. Plaintiffs' claims are typical of those of the Class. Prosecution of individual actions would create a risk of inconsistent adjudications. Plaintiffs will adequately protect the interests of the Class. A class action is superior to other available methods for the fair and efficient adjudication of this controversy.

### STATUTORY SAFE HARBOR

125. The statutory safe harbor provided for forward-looking statements ("FLS") does not apply to the false FLS pleaded. None of the *particular* oral FLS in Tut's conference calls and meetings with analysts were so identified as required. The defendants are liable for the false FLS pleaded because, at the time each FLS was made, the speaker knew the FLS was false and the FLS was authorized and/or approved by an executive officer of Tut who knew that the FLS was false. None of the historic or present-

1 tense statements made by defendants were assumptions underlying or relating to any plan, projection or  
2 statement of future economic performance, as they were not stated to be such assumptions underlying or  
3 relating to any projection or statement of future economic performance when made nor were any of the  
4 projections or forecasts made by defendants expressly related to or stated to be dependent on those historic  
5 or present-tense statements when made.

6 **CLAIM FOR RELIEF**

7 126. Defendants violated §10(b) and Rule 10b-5 by:

8 (a) Employing devices, schemes and artifices to defraud;  
9 (b) Making untrue statements of material facts and omitting to state material facts  
10 necessary in order to make the statements made, in light of the circumstances under which they were made,  
11 not misleading; and  
12 (c) Engaging in acts, practices and a course of business that operated as a fraud or  
13 deceit upon the Class in connection with their purchases of Tut securities.

14 127. Class members were damaged. In reliance on the integrity of the market, they paid  
15 artificially inflated prices for Tut securities.

16 **PRAYER**

17 WHEREFORE, plaintiffs pray for judgment as follows: declaring this action to be a proper class  
18 action; awarding damages, including interest; and such other equitable/injunctive or other relief as the Court  
19 may deem proper.

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## JURY DEMAND

Plaintiffs demand a trial by jury.

DATED: February 4, 2002

MILBERG WEISS BERSHAD  
HYNES & LERACH LLP  
JEFFREY W. LAWRENCE  
CHRISTOPHER P. SEEFER  
AZRA MEHDI (*pro hac vice*)

/s/ JEFFREY W. LAWRENCE  
JEFFREY W. LAWRENCE

100 Pine Street, Suite 2600  
San Francisco, CA 94111  
Telephone: 415/288-4545  
415/288-4534 (fax)

MILBERG WEISS BERSHAD  
HYNES & LERACH LLP  
WILLIAM S. LERACH  
DARREN J. ROBBINS  
401 B Street, Suite 1700  
San Diego, CA 92101  
Telephone: 619/231-1058  
619/231-7423 (fax)

WEISS & YOURMAN  
JOSEPH H. WEISS  
551 Fifth Avenue, Suite 1600  
New York, NY 10176  
Telephone: 212/682-3025  
212/682-3010 (fax)

## Co-Lead Counsel for Plaintiffs

G:\CASES\TUT\CMB80412.cpt

DECLARATION OF SERVICE BY FACSIMILE  
PURSUANT TO NORTHERN DISTRICT LOCAL RULE 23-2(c)(2)

I, the undersigned, declare:

1. That declarant is and was, at all times herein mentioned, a citizen of the United States and a resident of the County of San Francisco, over the age of 18 years, and not a party to or interest in the within action; that declarant's business address is 100 Pine Street, 26th Floor, San Francisco, California 94111.

2. That on February 4, 2002, declarant served by facsimile the CONSOLIDATED CLASS ACTION COMPLAINT FOR VIOLATION OF THE FEDERAL SECURITIES LAW to the parties listed on the attached Service List and this document was forwarded to the following designated Internet site at:

<http://securities.milberg.com>

3. That there is a regular communication by facsimile between the place of origin and the places so addressed.

I declare under penalty of perjury that the foregoing is true and correct. Executed this 4th day of February, 2002, at San Francisco, California.

/s/ Carolyn Burr  
Carolyn Burr

1 TUT SYSTEMS  
2 Service List - 02/04/02  
3 Page 1

4 COUNSEL FOR PLAINTIFF(S)

5 \* Kevin J. Yourman  
6 Jordan L. Lurie  
7 WEISS & YOURMAN  
8 10940 Wilshire Blvd., 24th Floor  
9 Los Angeles, CA 90024  
10 310/208-2800  
11 310/209-2348 (fax)

12 Jeffrey W. Lawrence  
13 Christopher P. Seefer  
14 MILBERG WEISS BERSHAD HYNES &  
15 LERACH LLP  
16 100 Pine Street, Suite 2600  
17 San Francisco, CA 94111  
18 415/288-4545  
19 415/288-4534 (fax)

20 William S. Lerach  
21 MILBERG WEISS BERSHAD HYNES &  
22 LERACH LLP  
23 401 B Street, Suite 1700  
24 San Diego, CA 92101-5050  
25 619/231-1058  
26 619/231-7423 (fax)

\* Joseph H. Weiss  
Jack I. Zwick  
WEISS & YOURMAN  
551 Fifth Avenue, Suite 1600  
212/682-3025  
212/682-3010 (fax)

27 COUNSEL FOR DEFENDANTS

28 Boris Feldman  
19 WILSON SONSINI GOODRICH &  
ROSATI, P.C.  
20 650 Page Mill Road  
21 Palo Alto, CA 94304-1050  
22 650/493-9300  
23 650/565-5100 (fax)

\*\*Matthew Taylor  
140 Springside Road  
Walnut Creek, CA 94694

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\*\*Denotes service via hand delivery on February 4, 2002.